

University of Mississippi

eGrove

---

Guides, Handbooks and Manuals

American Institute of Certified Public  
Accountants (AICPA) Historical Collection

---

1988

## **AICPA audit and accounting manual : nonauthoritative technical practice aids, as of June 1, 1988**

American Institute of Certified Public Accountants (AICPA)

Follow this and additional works at: [https://egrove.olemiss.edu/aicpa\\_guides](https://egrove.olemiss.edu/aicpa_guides)



Part of the [Accounting Commons](#), and the [Taxation Commons](#)

---



---

# **AICPA AUDIT AND ACCOUNTING MANUAL**

---

---

**Nonauthoritative Practice Aids**

---

---

**As of June 1, 1988**

---

**AICPA**

American Institute of Certified Public Accountants

**AICPA AUDIT AND ACCOUNTING  
MANUAL**  
As of June 1, 1988

**AICPA**



---

# **AICPA AUDIT AND ACCOUNTING MANUAL**

---

---

## **Nonauthoritative Practice Aids**

---

Edited by:  
**Linda J. Huntley, CPA**  
Technical Manager  
Technical Information Division

---

**As of June 1, 1988**

---



*Published for the*  
American Institute of  
Certified Public Accountants  
*by*  
COMMERCE CLEARING HOUSE, INC.  
4025 W. Peterson Ave.  
Chicago, Illinois 60646

---

Copyright © 1988, AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS, INC.  
1211 AVENUE OF THE AMERICAS, NEW YORK, NEW YORK 10036

---

All Rights Reserved  
Printed in the United States of America



# TABLE OF CONTENTS

Section		Page
.....	How to Use This Volume .....	1
AAM 1000	Introduction .....	1001
AAM 2000	Compilation and Review .....	2001
	2100 Introduction	
	2200 Engagement Planning and Administration	
	2300 Working Papers	
	2400 Form and Content of Financial Statements	
	2500 Accountants' Reports	
	2600 Special Areas	
AAM 3000	Engagement Planning and Administration .....	3001
	3100 Planning the Engagement	
	3105 Understanding the Assignment	
	3110 Assigning Personnel to the Engagement	
	3115 Independence	
	3120 Knowledge of the Entity's Business	
	3125 Assessing Auditability	
	3130 Preparing an Engagement Letter	
	3135 Assessment of Control Risk	
	3140 Assessing Audit Risk and Materiality	
	3145 Errors and Irregularities	
	3150 Illegal Acts	
	3155 Analytical Procedures	
	3160 Audit Strategies and the Audit Program	
	3165 Illustrative Planning Checklist	
	3170 Audit Assignment Controls	
	3175 Sample Engagement Letters	
AAM 4000	Internal Control Structure .....	4001
	4100 Introduction	
	4200 General Approach	
	4250 Internal Control Structure Considerations in a Minicomputer Environment	
	4300 Illustrative Internal Control Structure Questions—Small Business	
	4400 Illustrative Specific Internal Control Structure Objectives and Related Questions—Medium to Large Business	
	4500 Flowcharts	
	4600 Illustrative Internal Control Structure Questions—State and Local Governmental Units	
	4700 The Auditor's Assessment of Control Risk	



<i>Section</i>		<i>Page</i>
<b>AAM 5000</b>	<b>Audit Approach and Programs . . . . .</b>	<b>5001</b>
	5100 Designing the Audit Program	
	5200 Timing of Audit Tests	
	5300 Extent of Testing	
	5400 Illustrative Audit Program	
<b>AAM 6000</b>	<b>Working Papers . . . . .</b>	<b>6001</b>
	6100 Working Papers—General	
	6200 Basic Elements of Format	
	6300 Content of Working Papers	
	6400 Organization and Filing (Indexing)	
	6500 Sample Working Papers	
<b>AAM 7000</b>	<b>Correspondence, Confirmations &amp; Representations . . . . .</b>	<b>7001</b>
	7100 Control of Confirmations and Correspondence	
	7200 Requests for Confirmations and Related Materials	
	7300 Inquiries to Legal Counsel	
	7400 Representation Letters	
<b>AAM 9000</b>	<b>Review and Report Processing . . . . .</b>	<b>9001</b>
	9100 Supervision and Review Procedures	
	9210 Partner's Engagement Review Program	
	9220 Partner's Engagement Review Program for Not-for-Profit Organizations	
	9230 Partner's Engagement Review Program for Local Govern- mental Units	
	9500 Report Processing	
<b>AAM 10,000</b>	<b>Accountants' Reports . . . . .</b>	<b>10,001</b>
	10,100 Format of Accountants' Reports	
	10,210 Unqualified Opinions	
	10,220 Adverse Opinions	
	10,230 Disclaimers of Opinion	
	10,240 Qualified Opinions	
	10,245 Information Accompanying Audited Financial Statements	
	10,250 Engagements to Report on Internal Accounting Control	
	10,260 Special Reports	
	10,270 Unaudited Financial Statements of a Public Entity	
	10,280 Lack of Independence	
	10,300 Review of Interim Financial Information	
	10,400 Accountant's Report on Compilation of Financial Statements of a Nonpublic Entity	
	10,500 Accountant's Report on Review of Financial Statements of a Nonpublic Entity..	



<b>Section</b>		<b>Page</b>
<b>AAM 10,000</b>	<b>Accountants' Reports—Continued</b>	
	10,550 Accountant's Report on Condensed Financial Statements and Selected Financial Data	
	10,600 Reports on Personal Financial Statements	
	10,700 Accountant's Reports on Basic or General Purpose Financial Statements for State and Local Governmental Units	
<b>AAM 11,000</b>	<b>Quality Control Forms and Aids</b>	<b>11,001</b>
	11,100 Quality Control—General	
	11,200 Sample Quality Control Document for a Two-Partner Local CPA Firm	
	11,300 Sample Quality Control Document for a Four-Partner Local CPA Firm	
	11,400 Sample Quality Control Document for a Sole Practitioner CPA Firm Without Full-Time Staff	
	11,500 Sample Quality Control Document for a Sole Practitioner CPA Firm With Full-Time Staff	
	11,600 Sample Quality Control Forms	
<b>AAM</b>	<b>Appendixes</b>	<b>20,001</b>



# HOW TO USE THIS VOLUME

## Scope of the Volume . . .

This volume, which is a reprint of the looseleaf edition, brings together for continuing reference a set of nonauthoritative audit tools and illustrations prepared by the staff of the Technical Information Division of the American Institute of Certified Public Accountants.

## How This Volume Is Arranged . . .

The contents of this volume are arranged as follows:

- Introduction
- Compilation and Review
- Engagement Planning and Administration
- Internal Control Structure
- Audit Approach and Programs
- Working Papers
- Correspondence, Confirmations & Representations
- Review and Report Processing
- Accountants' Reports
- Quality Control Forms and Aids

## How to Use This Volume . . .

The arrangement of material is indicated in the general table of contents at the front of the volume. There is a detailed table of contents covering the material within each major division.

The major divisions are subdivided into sections, each with its own section number. Each paragraph within a section is decimally numbered. For example, AAM section 7100.01 refers to the first paragraph of section 7100, *Control of Confirmations and Correspondence*. Section and paragraph numbers located on each page are provided as corner references at the bottom of each page.

The *AICPA Professional Standards* is referenced by the use of the following abbreviations: AU (Auditing), AR (Accounting and Review Services), ET (Code of Conduct), BL (Bylaws), and QC (Quality Control).

The *FASB Accounting Standards Current Text* is referenced in a similar manner by the use of the abbreviation AC before the section and paragraph numbers. The *Current Text* contains an abridged version of the currently effective financial and reporting standards, as amended.

Quotations of accounting standards in this volume are derived from the original pronouncements and may have been editorially changed in the *Current Text*.

The Appendixes provide cross references from pronouncements of the American Institute of Certified Public Accountants and the Financial Accounting Standards Board to sections in the text.

---





# AAM Section 1000

## INTRODUCTION

This manual has not been approved, disapproved, or otherwise acted upon by any senior technical committees of the American Institute of Certified Public Accountants or the Financial Accounting Standards Board and has no official or authoritative status.

.01 This manual has been prepared by the staff of the American Institute of Certified Public Accountants and issued as a nonauthoritative kit of practice aids. The materials included in it are designed to serve as working tools and illustrations for timesaving purposes. They are not intended as a substitute for the professional judgments which must be applied by practitioners in any engagement. The manual, where practicable, offers choices and alternatives rather than particular positions. The manual is not a substitute for the authoritative technical literature and users are urged to refer directly to applicable authoritative pronouncements for the text of technical standards.

.02 Some sections of the manual include quotations from Statements on Auditing Standards and other authoritative pronouncements. Those quotations are intended only to illustrate certain matters, not to serve as a substitute for careful study of the relevant pronouncements. References are made throughout the manual to the original authoritative pronouncements and to their section numbers in *AICPA Professional Standards* and the *FASB Accounting Standards Current Text* to help users locate those authoritative pronouncements.

.03 The authors hope that the manual will be helpful to local firms and practitioners in the conduct of their audit and accounting practice. However, no generalized material, such as that included in this manual, can be a substitute for development and implementation by a firm of a system of quality control which is appropriately comprehensive and suitably designed in relation to the firm's organizational structure, its policies, and the nature of its practice.

.04 The manual is in looseleaf format in anticipation of updating and expansion. Changes are expected to arise from three main sources:

- (1) Comments and suggestions from practitioners. Since this manual is a product of AICPA staff, not of a committee of practitioners, it is particularly important that practitioners advise the staff on any suggestions for material that could be improved or added.
- (2) Issuance of new official pronouncements.
- (3) Other additions to or deletions from the manual as a result of continued staff study.

Comments and suggestions should be addressed to:

Technical Information Division  
AICPA  
1211 Avenue of the Americas  
New York, NY 10036

or call John Graves at (212) 575-6391.

John Graves, Director—Technical Services

---

Thomas W. McRae, Vice President—Technical  
Thomas P. Kelley, Group Vice President—Professional

---

**AICPA TECHNICAL HOTLINE**

The Technical Information Service answers inquiries about specific audit or accounting problems.

Call Toll Free

(800) 223-4158 (except New York)

(800) 522-5430 (New York only)

This service is free to AICPA members.

## AAM Section 2000

# COMPILATION AND REVIEW

This manual is a nonauthoritative kit of practice aids and, accordingly, does not include extensive explanation or discussion of authoritative pronouncements. Users of this manual are urged to refer directly to applicable authoritative pronouncements when appropriate.

The exhibits are for illustrative purposes only. They are included as conveniences for users of this manual who may want points of reference when preparing working papers or a report for a compilation or review engagement.

## TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
2100	Introduction . . . . .	.01-.13
2200	Engagement Planning and Administration . . . . .	.01-.25
	Understanding the Engagement . . . . .	.04-.07
	Engagement Letters . . . . .	.06-.07
	Change in Engagement Level of Service . . . . .	.08-.17
	Predecessor and Successor Accountant . . . . .	.18-.21
	Client Acceptance Form . . . . .	.22
	Client Information Form . . . . .	.23
	Illustrative Engagement Letter for a Compilation . . . . .	.24
	Illustrative Engagement Letter for a Review . . . . .	.25
2300	Working Papers . . . . .	.01-.19
	Compilation Engagements . . . . .	.01-.04
	Compilation Procedures . . . . .	.02-.03
	Compilation Checklists . . . . .	.04
	Review Engagements . . . . .	.05-.13
	Review Procedures—Inquiry . . . . .	.06-.07
	Review Procedures—Analytical . . . . .	.08-.11
	Representation Letters . . . . .	.12
	Review Checklists . . . . .	.13
	Short-Form Checklist for a Compilation Engagement . . . . .	.14
	Review of Financial Statements—Illustrative Inquiries . . . . .	.15
	Illustrative Ratio Analysis Worksheet . . . . .	.16
	Illustrative Analytical Procedures Comparative Report . . . . .	.17
	Review of Financial Statements—Illustrative Representation Letter . . . . .	.18
	Short-Form Checklist for a Review Engagement . . . . .	.19
2400	Form and Content of Financial Statements . . . . .	.01-.16
	Statements Prepared . . . . .	.01-.04
	Comparative Financial Statements . . . . .	.05-.07
	Notes to Financial Statements . . . . .	.08-.09
	Supplementary Information . . . . .	.10-.13
	Subsequent Discovery of Facts . . . . .	.14-.16
2500	Accountants' Reports . . . . .	.01-.31
	Compilation Report . . . . .	.06-.10
	Review Report . . . . .	.11-.16
	Modifications to Standard Report . . . . .	.17-.31

<i>Section</i>		<i>Paragraph</i>
2500	Accountants' Reports—continued	
	Omission of Substantially All Disclosures .....	.17-.19
	Omission of Statement of Cash Flows .....	.20
	GAAP Departures .....	.21-.23
	Scope Limitations .....	.24-.27
	Uncertainties .....	.28-.31
2600	Special Areas .....	.01-.05
	Prescribed Forms .....	.01-.04
	Specified Elements .....	.05

---

[The next page is 2101.]



# AAM Section 2100

## Introduction

.01 Statements on Standards for Accounting and Review Services (SSARS) are issued by the American Institute of Certified Public Accountants (AICPA) Accounting and Review Services Committee (ARSC), the senior technical committee of the AICPA designated by its Council to issue pronouncements in connection with unaudited financial statements and other unaudited financial information of nonpublic entities. A nonpublic entity is defined as any entity other than (a) one whose securities trade in a public market either on a stock exchange or over the counter, (b) one that files with a regulatory agency in preparation for the sale of any class of its securities in a public market, or (c) any entity controlled by an entity covered by (a) or (b).

.02 As of June 1988, ARSC had issued six Statements on Standards for Accounting and Review Services. They are

- SSARS 1      *Compilation and Review of Financial Statements* [AR section 100] (12/78)
- SSARS 2      *Reporting on Comparative Financial Statements* [AR section 200] (10/79)
- SSARS 3      *Compilation Reports on Financial Statements Included in Certain Prescribed Forms* [AR section 300] (12/81)
- SSARS 4      *Communications Between Predecessor and Successor Accountants* [AR section 400] (12/81)
- SSARS 5      *Reporting on Compiled Financial Statements* [AR section 500] (7/82)
- SSARS 6      *Reporting on Personal Financial Statements Included in Written Personal Financial Plans* [AR section 600] (9/86)

.03 SSARS 1 (AR section 100) defines a compilation of financial statements and a review of financial statements and is effective for compilations and reviews of financial statements for periods ending on or after July 1, 1979. A compilation of financial statements is defined as presenting in the form of financial statements information that is the representation of management without expressing any assurance on the statements. A review of financial statements involves performing inquiry and analytical procedures to provide the accountant with a reasonable basis for expressing limited assurance that there are no material modifications to the financial statements necessary for them to be in conformity with generally accepted accounting principles.

.04 SSARS 1, paragraph 4 (AR section 100.04), defines a financial statement as:

A presentation of financial data, including accompanying notes, derived from accounting records and intended to communicate an entity's economic resources or obligations at a point in time, or the changes therein for a period of time, in accordance with generally accepted accounting principles or a comprehensive basis of accounting other than generally accepted accounting principles. Financial forecasts, projections and similar presentations, and financial presentations included in tax returns are not financial statements for purposes of this statement. The following presentations are examples of financial statements:

- Balance sheet
- Statement of income
- Statement of retained earnings
- Statement of cash flows

- Statement of changes in owners' equity
- Statement of assets and liabilities (with or without owners' equity accounts)
- Statement of revenues and expenses
- Summary of operations
- Statement of operations by product lines
- Statement of cash receipts and disbursements

.05 SSARS 2 (AR section 200) establishes the standards for reporting on comparative financial statements of a nonpublic entity when the statements of one or more periods have been compiled or reviewed under SSARS 1 (AR section 100). SSARS 2 is effective for reports on comparative financial statements for periods ending on or after July 1, 1979.

.06 SSARS 3 (AR section 300) amends SSARS 1 and 2 (AR sections 100 and 200) to provide an alternative form of compilation report when a prescribed form calls for a departure from generally accepted accounting principles (GAAP). SSARS 3, paragraph 2 (AR section 300.02), defines a prescribed form as any preprinted form designed or adopted by the body to which it is intended to be submitted (e.g., banks, governmental bodies, etc.). Since this statement contains no effective date, it became effective upon issuance.

.07 SSARS 3 (AR section 300) does not prohibit the accountant from issuing a SSARS 1 (AR Section 100) compilation report which identifies GAAP departures in accordance with SSARS 1, paragraphs 39 through 41 (AR section 100.39—41). A SSARS 3 report is specifically designed to provide an alternative form of reporting when a prescribed form calls for a GAAP departure.

.08 SSARS 4 (AR section 400) provides guidance to a successor accountant who decides to communicate with the predecessor accountant. SSARS 4 does not require a successor accountant to communicate with a predecessor. Further, it deleted a footnote in SSARS 2 (AR section 200) suggesting that a successor accountant may wish to consult Statement on Auditing Standards No. 7, *Communications Between Predecessor and Successor Auditors* (AU section 315), in determining what communications would be appropriate. SSARS 4 was issued with no effective date, therefore, it became effective upon issuance.

.09 SSARS 5 (AR section 500) amends the reporting standard of SSARS 1 (AR section 100) by requiring that for all compilation engagements the accountant's report indicates that a compilation has been performed in accordance with standards established by the AICPA. The first sentence of the standard compilation report was also amended to reflect the amended reporting standard. SSARS 5 is effective for compilations of financial statements for periods ending on or after December 31, 1982.

.10 SSARS 6 (AR section 600) provides an exemption from SSARS 1 (AR section 100) for personal financial statements included in personal financial plans. SSARS 6 was issued with no effective date, therefore, it became effective upon issuance.

.11 Under SSARS 6 (AR section 600), an accountant may submit a written personal financial plan containing unaudited personal financial statements to a client without issuing a report under SSARS 1 (AR section 100), as amended, when—

- a. The accountant establishes an understanding with the client that the financial statements (i) will be used solely to assist the client and the client's advisors to develop the client's personal financial goals and objectives and (ii) will not be used to obtain credit or for any purpose other than developing the aforementioned goals and objectives.

- b. Nothing comes to the accountant's attention during the engagement that would cause him or her to believe that the financial statements will be used to obtain credit or for any purposes other than developing the client's financial goals and objectives.

.12 An accountant following the exemption under SSARS 6 (AR section 600) should issue a written report stating that the unaudited financial statements—

- a. Are designed solely to help develop the financial plan.
- b. May be incomplete or contain departures from GAAP and should not be used to obtain credit or for any purpose other than developing the plan.
- c. Have not been audited, reviewed, or compiled.

.13 Illustrative reports to be issued under the provisions of SSARS 1 through 6 can be found in AAM sections 10,400 and 10,500.

---

[The next page is 2201.]





# AAM Section 2200

## *Engagement Planning and Administration*

.01 It is important to remember that when engaged to provide compilation or review services, the accountant must comply with both Rules 201 and 202 of the AICPA's Code of Professional Conduct, *General Standards* and *Compliance With Standards*, respectively (ET sections 201.01 and 202.01). Rule 201 requires that an AICPA member comply with the following standards and any interpretations thereof by bodies designated by its Council:

- A. *Professional Competence*. Undertake only those professional services that the member or the member's firm can reasonably expect to be completed with professional competence.
- B. *Due Professional Care*. Exercise due professional care in the performance of professional services.
- C. *Planning and Supervision*. Adequately plan and supervise the performance of professional services.
- D. *Sufficient Relevant Data*. Obtain sufficient relevant data to afford a reasonable basis for conclusions or recommendations in relation to any professional services performed.

.02 Rule 202 requires that an AICPA member who performs auditing, review, compilation, management advisory, tax or other professional services comply with standards promulgated by bodies designated by Council.

.03 Prior to accepting an engagement to perform a compilation or review for a prospective client, the accountant should consider if he or she wishes to be associated with the client. Factors such as the ability of the accountant to adequately serve the client, the fee arrangement, client integrity, etc., need to be considered. It is often useful to complete a "Client Acceptance Form" to assist in determining whether or not to accept a client. An illustrative client acceptance form can be found in AAM section 2200.22.

### Understanding the Engagement

.04 SSARS 1, paragraph 8 (AR section 100.08), states that the accountant should establish an understanding with the entity regarding the services to be performed. This understanding should include a description of the nature and limitations of the services to be performed, and a description of the report the accountant expects to render. The understanding should also include an explanation that the engagement cannot be relied upon to disclose errors, irregularities, or illegal acts but should also indicate that if any such matters come to the accountant's attention, the entity will be notified. It is preferable that the understanding be in writing.

.05 It is a requirement of SSARS 1 (AR section 100) that an accountant have a knowledge of the entity's business when performing a compilation or review of its financial statements. The accountant should also possess a level of knowledge of the accounting principles and practices in the industry in which the entity operates. Many accountants find it helpful to complete a "Client Information Form" for their workpapers to document their understanding of the client. An illustrative form can be found in AAM section 2200.23.

### Engagement Letters

.06 An engagement letter provides a means of formalizing the understanding between the accountant and the client concerning the services to be rendered. An engagement letter may serve to help reduce or eliminate client misunderstanding and potential legal liability. Illustrative engagement letters for compilation and review engagements can be found in AAM section 2200.24 and .25, respectively.

.07 An engagement letter may cover various services to be rendered. For example, an accountant who performs monthly compilations and a year-end review for a given client, may issue only one engagement letter for that client detailing all services to be performed.

## Change in Engagement Level of Service

.08 An accountant who has been engaged to perform audit services with respect to financial statements may be requested by his or her client to change the level of service to be performed. SSARS 1, paragraphs 44 through 49 (AR section 100.44—.49), addresses changing the level of service to a lower level. A request to change the engagement to a review or a compilation may result from a change in circumstances affecting the entity's need for an audit, a misunderstanding of the nature of an audit or the alternative compilation and review services originally available, or a restriction on the scope of the audit, whether imposed by the client or caused by the circumstances.

.09 SSARS 1, paragraph 45 (AR section 100.45), states that before an accountant who was engaged to perform an audit agrees to change the engagement to a compilation or review, at least the following factors should be considered:

- a. The reason given for the client's request, particularly the implications of a restriction on the scope of the audit.
- b. The additional audit effort required to complete the audit.
- c. The estimated additional cost to complete the audit.

.10 A change in circumstances affecting the entity's need for an audit and a misunderstanding of the nature of an audit or the alternative compilation and review services originally available would normally be viewed as a reasonable basis for requesting a change in the level of service.

.11 The accountant should consider the implications of a restriction on the scope of the audit and should evaluate the possibility that information affected by the scope restriction may be incorrect, incomplete, or otherwise unsatisfactory. SSARS 1, paragraph 47 (AR section 100.47), describes the following two circumstances as ordinarily precluding the accountant from lowering his or her level of service from an audit to a compilation or review:

1. The accountant has been prohibited by the client from corresponding with the entity's legal counsel.
2. Management (owners) has refused to sign a client representation letter.

.12 SSARS 1, paragraph 48 (AR section 100.48), states that in all circumstances, if the auditing procedures are virtually complete or the cost to complete such procedures is relatively insignificant, the accountant should consider the propriety of accepting a change in the engagement.

.13 If the accountant agrees to lower the engagement from an audit to a compilation or review, he or she should issue an appropriate compilation or review report. The report should not make reference to the original engagement, any auditing procedures that may have been performed, or any scope limitations that resulted in the changed engagement.

.14 Other situations involving changes in the level of service include changing the level of service from a review to a compilation and also a step-down from full disclosure to omission of substantially all disclosures.

.15 Regarding a change from a review to a compilation, SSARS 1, paragraph 36 (AR section 100.36), indicates that the accountant should consider the same matters as those discussed in AAM section 2200.09 and .10 above.

.16 Interpretation 1 of SSARS 1, "Omission of Disclosures in Reviewed Financial Statements" (AR section 9100.01—.02), prohibits an accountant from issuing a review report of financial statements which omit substantially all disclosures. For a compilation engagement, it is generally acceptable for an accountant to lower the engagement to financial statements that omit substantially all disclosures from a full disclosure compilation when it can be justified that the change in the engagement was not undertaken with the intent to mislead.

.17 The issue of changing the level of an engagement to a higher level of service is not specifically addressed in SSARS 1 (AR section 100). It is generally agreed that a change to a higher level of service is acceptable. In such

circumstances, the accountant should be certain that it is possible to comply with the applicable standards for the revised level of service. It is also wise to revise his understanding with the client of the changed engagement, preferably by amending the engagement letter.

## **Predecessor and Successor Accountant**

.18 SSARS 4 (AR section 400) provides guidance to a successor accountant who decides to communicate with a predecessor accountant. Unlike an audit engagement, there is no requirement that the successor accountant communicate with the predecessor accountant in a compilation or review engagement. However, in accordance with SSARS 4, paragraph 3 (AR section 400.03), under the following circumstances the accountant may decide to do so:

- a. Information about the prospective client and its management and principals is limited or appears to require special attention.
- b. The change in accountants takes place substantially after the end of the accounting period for which financial statements are to be compiled or reviewed.
- c. There have been frequent changes in accountants.

.19 According to SSARS 4, paragraph 4 (AR section 400.04), when the successor accountant decides to communicate with the predecessor, he or she should request the client to (1) permit him or her to make inquiries of the predecessor and (2) authorize the predecessor to fully respond to those inquiries.

.20 The inquiries of the successor accountant will normally include questions concerning (1) information that might bear on the integrity of management (owners), (2) disagreements with management (owners) about accounting principles or the necessity of performing certain procedures, (3) the cooperation of management in providing additional or revised information, when necessary, and (4) the predecessor's understanding of the reasons for the change of accountants.

.21 The predecessor accountant is expected to respond both promptly and fully to requests of the type cited in the aforementioned paragraph. Valid business reasons (e.g., unpaid fees) may preclude the predecessor from responding to the inquiries of the successor. The predecessor may also decide, due to unusual circumstances such as impending litigation, not to respond fully to the successor. In such an instance, the predecessor should indicate that the response is limited and the successor should consider both the reasons for and implications of such a response in deciding whether to undertake the engagement.

**.22 Client Acceptance Form**

INSTRUCTIONS: This form should be completed  
for each prospective client before accepting  
an engagement.

Client Name:

Address:

Telephone Number:

Form of Legal Entity:  
(partnership, corporation, etc.)

What type of business is the client in?

List management and officers of the client:

How did we become aware of this potential client?

Are the client's accounting services now being performed by another accounting firm? If yes, what is the name of the firm and the client's reason for changing accounting firms?

Have we contacted the client's previous accounting firm? If yes, list their comments. If not, explain why.

Does the client owe fees to the previous accountants?

Did we have prior knowledge of the client? If not, list the names of references checked and any comments.

What services would our firm be expected to perform? What would the timing of these services be?

Estimate the net fees and describe the billing arrangements.

Is there any reason to doubt the client's management or officers' representations or integrity? If yes, describe.

Are we aware of any independence problems between this client and our staff? If yes, describe.

Does our firm have the necessary expertise and staff to perform the engagement properly?



*Comments:*

*Conclusions*

\_\_\_\_\_ Accept Engagement

\_\_\_\_\_ Not Accept Engagement

Form prepared by \_\_\_\_\_ Date \_\_\_\_\_

Engagement Partner \_\_\_\_\_ Date \_\_\_\_\_

Concurring Partner \_\_\_\_\_ Date \_\_\_\_\_

**.23 Client Information Form**

INSTRUCTIONS: This form should be completed for each client before beginning our first engagement. The form should be updated annually.

Client Name:

Form of Legal Entity:  
(partnership, corporation, etc.)

What type of business is the client in?

List the sources of authoritative literature which describe any specialized accounting principles that are or should be followed by this client.

Does this client have any accounting principles or policies that are specific to this entity. Please describe.

On what basis of accounting are the financial statements being presented?

List the key members of management.

List the major stockholders of the client and their percentage of ownership, if known:

List all related parties. (e.g., subsidiaries, affiliated companies)

Describe any transactions between the client and these related parties.

How many employees does the client have?

How many locations does the client have?

List each location, the type of activity (e.g., plant, home office, etc.) done at each location and the number of employees at the location.

<i>Location</i>	<i>Activity</i>	<i>Number of Employees</i>
-----------------	-----------------	--------------------------------

Describe the client's major assets.

Describe the client's major liabilities.

Describe the client's major sources of revenue.

Describe the client's major expenses.

[NOTE: If the client is in manufacturing, then other operating characteristics which should be described are the components of cost of goods sold, any marketing methods and the production process.]

List key accounting records which are expected to be reviewed and identify the person responsible and the form of the records (manual, computer, service bureau).

*Accounting Record*

*Person Responsible*

*Form*

General Ledger

Journals

Cash Receipts

Cash Disbursements

Payroll

Sales

Purchases

Voucher Register

**Subsidiary Ledgers**

Accounts Receivable

Accounts Payable

Perpetual Inventory

Fixed Assets

*Comments:*

Prepared By: \_\_\_\_\_ Date \_\_\_\_\_

**.24 Illustrative Engagement Letter for a Compilation**

SWIFT, MARCH &amp; COMPANY

Certified Public Accountants

[Date]

Mr. Tom Jones, President

ZYXWV Freight Corporation

648 Crystal Lane

Noplace, Anystate 00000

Dear Mr. Jones:

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

1. We will compile, from information you provide, the annual and interim balance sheets and related statements of income, retained earnings and cash flows of ZYXWV Freight Corporation for the year 19XX. We will not audit or review such financial statements. Our report on the annual financial statements of ZYXWV Freight Corporation is presently expected to read as follows:

We have compiled the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). We have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

Our report on your interim financial statements, which statements will omit substantially all disclosures, will include an additional paragraph that will read as follows:

Management has elected to omit substantially all of the disclosures required by generally accepted accounting principles. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and changes in financial position. Accordingly, these financial statements are not designed for those who are not informed about such matters.

If, for any reason, we are unable to complete the compilation of your financial statements, we will not issue a report on such statements as a result of this engagement.

2. We will assist your bookkeeper in adjusting the books of account so that he will be able to prepare a working trial balance from which financial statements can be compiled. Your bookkeeper will provide us with a detailed trial balance and any supporting schedules we require.
3. We will also prepare the federal and state [*identify states*] income tax returns for ZYXWV Freight Corporation for the fiscal year ended December 31, 19XX.

Our engagement cannot be relied upon to disclose errors, irregularities, or illegal acts, including fraud or defalcations, that may exist. However, we will inform you of any such matters that come to our attention.

Our fees for these services....

We shall be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.\*

Sincerely yours,

---

Swift, March & Company

Acknowledge:

ZYXWV Freight Corporation

---

President

---

Date

---

\*Some accountants prefer not to obtain an acknowledgment, in which case their letter would omit the paragraph beginning "If the foregoing..." and the spaces for the acknowledgment. The first paragraph of their letter might begin as follows: "This letter sets forth our understanding of the terms and objectives of our engagement..."

**.25 Illustrative Engagement Letter for a Review**

SWIFT, MARCH &amp; COMPANY

Certified Public Accountants

[Date]

Mr. Tom Jones, President

ZYXWV Freight Corporation

648 Crystal Lane

Noplace, Anystate 00000

Dear Mr. Jones:

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

1. We will review the balance sheet of ZYXWV Freight Corporation as of [date], and the related statements of income, retained earnings and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. We will not perform an audit of such financial statements, the objective of which is the expression of an opinion regarding the financial statements taken as a whole, and, accordingly, we will not express such an opinion on them. Our report on the financial statements is presently expected to read as follows:

We have reviewed the accompanying balance sheet of ZYXWV Corporation as of December 31, 19XX, and the related statements of income, retained earnings and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management of ZYXWV Freight Corporation.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

If, for any reason, we are unable to complete our review of your financial statements, we will not issue a report on such statements as a result of this engagement.

2. We will provide your chief accountant with such consultation on accounting matters as he may require in adjusting and closing the books of account and in drafting financial statements for our review. Your chief accountant also will provide us with a detailed trial balance and any supporting schedules we require.
3. We will also prepare the federal and state [identify states] income tax returns for ZYXWV Freight Corporation for the fiscal year ended December 31, 19XX.

Our engagement cannot be relied upon to disclose errors, irregularities, or illegal acts, including fraud or defalcations, that may exist. However, we will inform you of any such matters that come to our attention.



Our fees for these services....

We shall be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.\*

Sincerely yours,

---

Swift, March & Company

Acknowledge:

ZYXWV Freight Corporation

---

President

---

Date

---

[The next page is 2301.]

---

\*Some accountants prefer not to obtain an acknowledgment, in which case their letter would omit the paragraph beginning "If the foregoing..." and the spaces for the acknowledgment. The first paragraph of their letter might begin as follows: "This letter sets forth our understanding of the terms and objectives of our engagement..."

# AAM Section 2300

## *Working Papers*

### Compilation Engagements

.01 SSARS 1 (AR section 100) does not address workpaper documentation for a compilation engagement. However, many accountants prefer compilation workpapers that include all necessary documentation to verify that compilation procedures were performed. In determining what workpapers the accountant will need, he or she should consider any peer review requirements that the firm will need to meet. AAM section 11,000 offers a discussion on compliance with the AICPA's quality control standards.

### Compilation Procedures

.02 The following items are generally documented in a CPA's compilation workpapers:

- Documentation of the accountant's knowledge of the client's business and the accounting principles and practices of the industry in which the entity operates
- Documentation of the understanding with the client concerning the services to be rendered, usually in the form of an engagement letter
- Documentation that the accountant has read the compiled financial statements
- Support for a change in the level of service performed, if necessary
- Working trial balance
- Reasons for omitting substantially all disclosures
- Documentation of discussions of unusual items

.03 In addition, if the CPA prepares the financial statements as well as compiles them, he or she should also include in the workpapers the following:

- Support for information in the notes to the financial statements
- Copies of preliminary client records (e.g., working trial balance and adjustments) required to arrive at final compiled financial statements

### Compilation Checklists

.04 Procedural checklists can serve as means of documenting in the workpapers that all the necessary procedures have been performed. When completing a procedural checklist, the accountant should refer to the specific workpaper documenting completion of the checklist step. An illustrative procedural checklist for a compilation can be found in AAM section 2300.14.

### Review Engagements

.05 As noted in section 2100, a review of financial statements involves performing inquiry and analytical procedures. SSARS 1, paragraph 30 (AR section 100.30), discusses workpaper documentation for review engagements. SSARS 1 (AR section 100) does not specify the form or content of the working papers in connection with a review engagement, but paragraph 30 does state that the working papers should describe the following:

- a. The matters covered in the accountant's inquiry and analytical procedures

- b. Unusual matters that the accountant considered during the performance of the review, including their disposition

### Review Procedures—Inquiry

.06 SSARS 1, paragraph 27 (AR section 100.27), states that the accountant's inquiries should generally consist of the following:

- a. Inquiries concerning the entity's accounting principles and practices and the methods followed in applying them.
- b. Inquiries concerning the entity's procedures for recording, classifying, and summarizing transactions, and accumulating information for disclosure in the financial statements.
- c. Inquiries concerning actions taken at meetings of stockholders, board of directors, committees of the board of directors, or comparable meetings that may affect the financial statements.
- d. Inquiries of persons having responsibility for financial and accounting matters concerning (1) whether the financial statements have been prepared in conformity with generally accepted accounting principles consistently applied, (2) changes in the entity's business activities or accounting principles and practices, (3) matters as to which questions have arisen in the course of applying the foregoing procedures, and (4) events subsequent to the date of the financial statements that would have a material effect on the financial statements.

.07 SSARS 1, Appendix A (AR section 100.52), contains illustrative inquiries in connection with a review engagement. These illustrative inquiries appear in AAM section 2300.15. These inquiries do not necessarily apply to all engagements, nor are they meant to be all-inclusive.

### Review Procedures—Analytical

.08 SSARS 1, paragraph 27c (AR section 100.27c), states that analytical procedures consist of the following:

- 1. Comparison of the financial statements with statements for a comparable prior period(s)
- 2. Comparison of the financial statements with anticipated results, if available
- 3. Study of the relationship of the elements of the financial statements that would be expected to conform to a predictable pattern based on the entity's experience

.09 Three common forms of analytical procedures are ratio analysis, trend analysis, and tests for reasonableness of data. Once the accountant performs his analytical procedures, he or she must evaluate the results, usually against past historical results or industry averages. Illustrative analytical procedures workpapers can be found in AAM section 2300.16 and .17.

.10 SSARS 1, paragraph 27 (AR section 100.27), also suggests that the following review procedures be performed:

- a. Reading the financial statements to consider, on the basis of information coming to the accountant's attention, whether the financial statements appear to conform with generally accepted accounting principles
- b. Obtaining reports from other accountants, if any, who have been engaged to audit or review the financial statements of significant components of the reporting entity, its subsidiaries, and other investees

.11 The following items are usually included in the workpapers for a review engagement:

- Documentation of the accountant's knowledge of the client's business and the accounting principles and practices of the industry in which it operates

- An engagement letter
- Support for a change in the level of service, if any
- Documentation of all inquiries and respective responses
- Documentation of all analytical procedures
- A representation letter
- Documentation of discussions of unusual matters
- Copies of reports of other accountants who have performed services with respect to a subsidiary or other significant investee

## **Representation Letters**

.12 SSARS 1, paragraph 31 (AR section 100.31), states that the accountant may wish to obtain a representation letter from the owner, manager, or chief executive officer. Many accountants believe that the “may” is not as optional as it sounds and that representation letters should be obtained for all review engagements, as is the case in audit engagements. An illustrative representation letter for a review engagement can be found in AAM section 2300.18.

## **Review Checklists**

.13 In the same way that procedural checklists are suggested for compilation engagements, it is wise to prepare such a checklist for a review engagement. An illustrative procedural checklist for a review engagement can be found in AAM section 2300.19.

**.14 Short-Form Checklist for a Compilation Engagement**

	<i>AR Ref.*</i>	<i>Initials</i>
1. Obtain an engagement letter.	.08	_____
2. Acquire the necessary knowledge of client's industry accounting principles and practices.	.10	_____
3. Acquire a general understanding of the client's business transactions, the form of the accounting records, the stated qualifications of the accounting personnel, the accounting basis used, and the form and content of the financial statements. (It is not necessary to make inquiries or perform other procedures unless the information supplied is questionable.)	.11-.12	_____
4. Read the financial statements and determine if they are appropriate in form and free from obvious material error.	.13	_____
5. Consider whether all disclosures required by generally accepted accounting principles (GAAP) or an acceptable comprehensive basis of accounting are provided. If they are not, go to step 6. If they are, go to step 7.	.19	_____
6. If substantially all disclosures required by GAAP or an other comprehensive basis of accounting are omitted, indicate this in a separate paragraph in your report; if a comprehensive basis of accounting other than GAAP is used, disclose this basis either in the financial statements or in your report. If the statement of cash flows is also omitted in GAAP statements, modify the scope paragraph and disclosure deficiency paragraph accordingly. If most, but not all, disclosures are omitted, notes to the financial statements should be labeled "Selected Information—Substantially All Disclosures Required by Generally Accepted Accounting Principles Are Not Included."	.19-.21	_____
7. Consider whether the financial statements contain measurement departures from GAAP or other comprehensive basis of accounting. If they do, go to step 8. If they do not, go to step 9.	.39	_____
8. Get client to revise the financial statements. Failing that, consider modifying your report by adding a separate paragraph or paragraphs. If the impact of the departure has been determined by management or is known by you, disclose the dollar effects in your report. (However, uncertainties and inconsistencies are not measurement departures if they are properly disclosed. See step 5.) Withdraw from the engagement if the GAAP departures are designed to mislead statement users.	.39-.40	_____
9. Determine whether the firm is independent. If the firm is not, go to step 10. If the firm is, go to step 11.	.22	_____
10. If the firm is not independent, add a separate paragraph to your report: "I am (we are) not independent with respect to XYZ Company."	.22	_____
11. If the financial statements are accompanied by information presented for supplementary analysis purposes, include such other data in the compilation report.	.43	_____
12. Mark each page of the financial statements, including any supplemental data, "See accompanying notes and accountant's report."	.16	_____
13. Date your report using the date the compilation was completed.	.15	_____
14. Issue the financial statements and related compilation report.	.14	_____
15. If subsequent to the date of the report, facts that would possibly cause the financial statements to be misleading are discovered (and were in existence at the report date), consult SAS No. 1, section 561 (AU section 561), Interpretation No. 4 of SSARS No. 1 (AR section 9100.13—.15), and your attorney.	.42	_____

Completed by \_\_\_\_\_ Date: \_\_\_\_\_

\* The abbreviation "AR Ref." in this checklist means AR section 100. All references in this checklist are to paragraphs in AR section 100.

**.15 Review of Financial Statements—Illustrative Inquiries****1. General**

- a. What are the procedures for recording, classifying, and summarizing transactions (relates to each section discussed below)?
- b. Do the general ledger control accounts agree with subsidiary records (for example, receivables, inventories, investments, property and equipment, accounts payable, accrued expenses, non-current liabilities)?
- c. Have accounting principles been applied on a consistent basis?

**2. Cash**

- a. Have bank balances been reconciled with book balances?
- b. Have old or unusual reconciling items between bank balances and book balances been reviewed and adjustments made where necessary?
- c. Has a proper cutoff of cash transactions been made?
- d. Are there any restrictions on the availability of cash balances?
- e. Have cash funds been counted and reconciled with control accounts?

**3. Receivables**

- a. Has an adequate allowance been made for doubtful accounts?
- b. Have receivables considered uncollectible been written off?
- c. If appropriate, has interest been reflected?
- d. Has a proper cutoff of sales transactions been made?
- e. Are there any receivables from employees and related parties?
- f. Are any receivables pledged, discounted, or factored?
- g. Have receivables been properly classified between current and noncurrent?

**4. Inventories**

- a. Have inventories been physically counted? If not, how have inventories been determined?
- b. Have general ledger control accounts been adjusted to agree with physical inventories?
- c. If physical inventories are taken at a date other than the balance sheet date, what procedures were used to record changes in inventory between the date of the physical inventory and the balance sheet date?
- d. Were consignments in or out considered in taking physical inventories?
- e. What is the basis of valuation?
- f. Does inventory cost include material, labor, and overhead where applicable?
- g. Have write-downs for obsolescence or cost in excess of net realizable value been made?
- h. Have proper cutoffs of purchases, goods in transit, and returned goods been made?
- i. Are there any inventory encumbrances?

5. Prepaid Expenses
  - a. What is the nature of the amounts included in prepaid expenses?
  - b. How are these amounts amortized?
6. Investments, Including Loans, Mortgages, and Intercompany Investments
  - a. Have gains and losses on disposal been reflected?
  - b. Has investment income been reflected?
  - c. Has appropriate consideration been given to the classification of investments between current and noncurrent, and the difference between the cost and market value of investments?
  - d. Have consolidation or equity accounting requirements been considered?
  - e. What is the basis of valuation of marketable equity securities?
  - f. Are investments unencumbered?
7. Property and Equipment
  - a. Have gains or losses on disposal of property or equipment been reflected?
  - b. What are the criteria for capitalization of property and equipment? Have such criteria been applied during the fiscal period?
  - c. Does the repairs and maintenance account only include items of an expense nature?
  - d. Are property and equipment stated at cost?
  - e. What are the depreciation methods and rates? Are they appropriate and consistent?
  - f. Are there any unrecorded additions, retirements, abandonments, sales, or trade-ins?
  - g. Does the entity have material lease agreements? Have they been properly reflected?
  - h. Is any property or equipment mortgaged or otherwise encumbered?
8. Other Assets
  - a. What is the nature of the amounts included in other assets?
  - b. Do these assets represent costs that will benefit future periods? What is the amortization policy? Is it appropriate?
  - c. Have other assets been properly classified between current and noncurrent?
  - d. Are any of these assets mortgaged or otherwise encumbered?
9. Accounts and Notes Payable and Accrued Liabilities
  - a. Have all significant payables been reflected?
  - b. Are all bank and other short-term liabilities properly classified?
  - c. Have all significant accruals, such as payroll, interest, and provisions for pension and profit-sharing plans been reflected?
  - d. Are there any collateralized liabilities?
  - e. Are there any payables to employees and related parties?

## 10. Long-Term Liabilities

- a. What are the terms and other provisions of long-term liability agreements?
- b. Have liabilities been properly classified between current and non-current?
- c. Has interest expense been reflected?
- d. Has there been compliance with restrictive covenants of loan agreements?
- e. Are any long-term liabilities collateralized or subordinated?

## 11. Income and Other Taxes

- a. Has provision been made for current and prior-year federal income taxes payable?
- b. Have any assessments or reassessments been received? Are there tax examinations in process?
- c. Are there timing differences? If so, have deferred taxes been reflected?
- d. Has provision been made for state and local income, franchise, sales, and other taxes payable?

## 12. Other Liabilities, Contingencies, and Commitments

- a. What is the nature of the amounts included in other liabilities?
- b. Have other liabilities been properly classified between current and noncurrent?
- c. Are there any contingent liabilities, such as discounted notes, drafts, endorsements, warranties, litigation, and unsettled asserted claims? Are there any unasserted potential claims?
- d. Are there any material contractual obligations for construction or purchase of real property and equipment and any commitments or options to purchase or sell company securities?

## 13. Equity

- a. What is the nature of any changes in equity accounts?
- b. What classes of capital stock have been authorized?
- c. What is the par or stated value of the various classes of stock?
- d. Do amounts of outstanding shares of capital stock agree with subsidiary records?
- e. Have capital stock preferences, if any, been disclosed?
- f. Have stock options been granted?
- g. Has the entity made any acquisitions of its own capital stock?
- h. Are there any restrictions on retained earnings or other capital?

## 14. Revenue and Expenses

- a. Are revenues from the sale of major products and services recognized in the appropriate period?
- b. Are purchases and expenses recognized in the appropriate period and properly classified?
- c. Do the financial statements include discontinued operations or items that might be considered extraordinary?



## 15. Other

- a. Are there any events that occurred after the end of the fiscal period that have a significant effect on the financial statements?
- b. Have actions taken at stockholder, board of directors, or comparable meetings that affect the financial statements been reflected?
- c. Have there been any material transactions between related parties?
- d. Are there any material uncertainties? Is there any change in the status of material uncertainties previously disclosed?

**.16 Illustrative Ratio Analysis Worksheet**

Below you will find 34 financial ratios. These financial ratios include all of the key ratios included in Robert Morris Associates Annual Statement Studies [Published by Robert Morris Associates, Philadelphia, PA] and Dun and Bradstreet's Key Business Ratios [Published by Dun and Bradstreet Credit Services, Murray Hill, NJ].

<u>Ratio Name</u>		<u>Formula for Ratio</u>	<u>Calculations</u>
1.	Current Ratio	$= \frac{\text{Current Assets}}{\text{Current Liabilities}}$	=
2.	Quick Ratio	$= \frac{\text{Quick Assets}}{\text{Current Liabilities}}$	=
3.	Days Sales in Accounts Receivable	$= \frac{\text{Accounts Receivable (net)}}{\text{Net Sales}}$	=
4.	Allowance for Bad Debts as a % of A/R	$= \frac{\text{Allowance for Bad Debts}}{\text{Accounts Receivable}}$	=
5.	Bad Debt Exp. as a Percentage of Net Sales	$= \frac{\text{Bad Debt Expense}}{\text{Net Sales}}$	=
6.	Inventory Turnover	$= \frac{\text{Cost of Sales} \times (\text{Days/Year})}{\text{Inventory} \times (\text{Days/Period})}$	=
7.	Net Sales to Inventory	$= \frac{\text{Net Sales} \times (\text{Days/Year})}{\text{Inventory} \times (\text{Days/Period})}$	=
8.	Days Inventory	$= \frac{\text{Inventory} \times (\text{Days/Period})}{\text{Cost of Sales}}$	=
9.	Net Fixed Assets to Net Worth	$= \frac{\text{Net Fixed Assets}}{\text{Net Worth}}$	=
10.	Current Liabilities to Net Worth	$= \frac{\text{Current Liabilities}}{\text{Net Worth}}$	=
11.	Current Liabilities to Inventory	$= \frac{\text{Current Liabilities}}{\text{Inventory}}$	=
12.	Accounts Payable to Net Sales	$= \frac{\text{Accts. Payable} \times (\text{Days/Period})}{\text{Net Sales} \times (\text{Days/Year})}$	=
13.	Total Liabilities to Net Worth	$= \frac{\text{Total Liabilities}}{\text{Net Worth}}$	=

	<u>Ratio Name</u>		<u>Formula for Ratio</u>		<u>Calculations</u>
14.	Net Worth to Total Liabilities	=	$\frac{\text{Net Worth}}{\text{Total Liabilities}}$	=	
15.	Net Sales to Working Capital	=	$\frac{\text{Net Sales} \times (\text{Days/Year})}{\text{Working Capital} \times (\text{Days/Per.})}$	=	
16.	Total Assets to Net Sales	=	$\frac{\text{Total Assets} \times (\text{Days/Period})}{\text{Net Sales} \times (\text{Days/Year})}$	=	
17.	Return on Total Assets	=	$\frac{\text{Net Income} \times (\text{Days/Year})}{\text{Total Assets} \times (\text{Days/Period})}$	=	
18.	Return on Net Worth	=	$\frac{\text{Net Income} \times (\text{Days/Year})}{\text{Net Worth} \times (\text{Days/Period})}$	=	
19.	Return on Net Sales	=	$\frac{\text{Net Income}}{\text{Net Sales}}$	=	
20.	Net Sales to Accounts Receivable	=	$\frac{\text{Net Sales} \times (\text{Days/Year})}{\text{A/R (net)} \times (\text{Days/Period})}$	=	
21.	Net Sales to Net Fixed Assets	=	$\frac{\text{Net Sales} \times (\text{Days/Year})}{\text{Fixed Assets} \times (\text{Days/Period})}$	=	
22.	Net Sales to Total Assets	=	$\frac{\text{Net Sales} \times (\text{Days/Year})}{\text{Total Assets} \times (\text{Days/Period})}$	=	
23.	Net Sales to Net Worth	=	$\frac{\text{Net Sales} \times (\text{Days/Year})}{\text{Net Worth} \times (\text{Days/Period})}$	=	
24.	Days Payables in Cost of Sales	=	$\frac{\text{Accts. Payable} \times (\text{Days/Period})}{\text{Cost of Sales}}$	=	
25.	Income Before Tax to Net Worth	=	$\frac{\text{Inc. Before Tax} \times (\text{Days/Year})}{\text{Net Worth} \times (\text{Days/Period})}$	=	
26.	Income Before Tax to Total Assets	=	$\frac{\text{Inc. Before Tax} \times (\text{Days/Year})}{\text{Total Assets} \times (\text{Days/Period})}$	=	
27.	Retained Earnings to Net Income	=	$\frac{\text{Ret. Earn.} \times (\text{Days/Period})}{\text{Net Income} \times (\text{Days/Year})}$	=	
28.	Gross Profit Percentage	=	$\frac{\text{Net Sales} - \text{Cost of Sales}}{\text{Net Sales}}$	=	

	<u>Ratio Name</u>		<u>Formula for Ratio</u>		<u>Calculations</u>
29.	Operating Expenses as a % of Net Sales	=	$\frac{\text{Operating Expenses}}{\text{Net Sales}}$	=	
30.	Times Interest Earned	=	$\frac{\text{Inc. Before Interest and Taxes}}{\text{Interest Expense}}$	=	
31.	Interest Expenses to Net Sales	=	$\frac{\text{Interest Expense}}{\text{Net Sales}}$	=	
32.	Amort/Deprec Expense to Net Sales	=	$\frac{\text{Amort. and Deprec. Expense}}{\text{Net Sales}}$	=	
33.	Officers Compensation to Net Sales	=	$\frac{\text{Officers Compensation}}{\text{Net Sales}}$	=	
34.	Altman Z Score	=	The Altman Z Score, developed by Edward I. Altman, is a composite formula that is widely used to measure the financial "health" of a company. The formula takes four financial ratios and multiplies each by a specific constant. The amounts so computed are added together to obtain an overall score. This score is then compared to scores from other companies to rate relative financial health. The formula is as follows:		
	$\frac{\text{Working Capital}}{\text{Total Assets}}$	×	6.56	=	
	$\frac{\text{Retained Earnings}}{\text{Total Assets}}$	×	3.26	=	
	$\frac{\text{Income Before Tax}}{\text{Total Assets}}$	×	6.72	=	
	$\frac{\text{Net Worth}}{\text{Total Liabilities}}$	×	1.05	=	
			Altman Z Score		<hr/> <hr/>

**.17 Illustrative Analytical Procedures Comparative Report**

**Sample Services, Inc.**  
**Analytical Procedures Comparative Report**  
**For the period ended December 31, 19XX**

Prepared by \_\_\_\_\_

Reviewed by \_\_\_\_\_

Account Name	Account #	Prior	Ending	Net Change	%
Cash—Operating	110				
Cash—Savings	115				
Petty Cash	118				
Accounts Receivable	120				
Prepaid Insurance	130				
Prepaid Dues	131				
Prepaid Interest	132				
Supplies Inventory	140				
Land	200				
Buildings	210				
Accum. Depr.—Buildings	215				
Equipment	220				
Accum. Depr.—Equipment	225				
Other Assets	250				
Notes Payable	310				
Accounts Payable	330				
Accrued Liabilities	340				
Long-term Debt	390				
Common Stock	400				
Paid-in Capital	410				
Retained Earnings	450				
Sales	510				
Interest Income	520				
Other Revenue	530				
Automobile	700				
Bad Debts	705				
Depreciation	710				
Donations	715				
Insurance	720				
Interest	725				
Licenses & Dues	730				
Medical Insurance	735				
Payroll Taxes	740				
Postage	745				
Professional Fees	750				
Profit Sharing	755				
Repairs & Maintenance	760				
Salaries—Employees	765				
Salaries—Officers	767				
Supplies	770				
Telephone	775				
Travel	780				
Utilities	785				
Miscellaneous	790				
Net Balance		_____	_____	_____	
		=====	=====	=====	

**.18 Review of Financial Statements—Illustrative Representation Letter**

(Date of Accountant's Report)

(To the Accountant)

In connection with your review of the (identification of financial statements) of (name of client) as of (date) and for the (period of review) for the purpose of expressing limited assurance that there are no material modifications that should be made to the statements in order for them to be in conformity with generally accepted accounting principles, we confirm, to the best of our knowledge and belief, the following representations made to you during your review.

1. The financial statements referred to above present the financial position, results of operations, and changes in financial position of (name of client) in conformity with generally accepted accounting principles. In that connection, we specifically confirm that—
  - a. The company's accounting principles, and the practices and methods followed in applying them, are as disclosed in the financial statements.
  - b. There have been no changes during the (period reviewed) in the company's accounting principles and practices.
  - c. We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.
  - d. There are no material transactions that have not been properly reflected in the financial statements.
  - e. There are no material losses (such as from obsolete inventory or purchase or sales commitments) that have not been properly accrued or disclosed in the financial statements.
  - f. There are no violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency, and there are no other material liabilities or gain or loss contingencies that are required to be accrued or disclosed.
  - g. The company has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged.
  - h. There are no related party transactions or related amounts receivable or payable that have not been properly disclosed in the financial statements.
  - i. We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
  - j. No events have occurred subsequent to the balance sheet date that would require adjustment to, or disclosure in, the financial statements.

2. We have advised you of all actions taken at meetings of stockholders, board of directors, and committees of the board of directors (or other similar bodies, as applicable) that may affect the financial statements.
3. We have responded fully to all inquiries made to us by you during your review.

---

(Name of Owner or Chief  
Executive  
Officer and Title)

---

(Name of Chief Financial Officer  
and  
Title, where applicable)

**.19 Short-Form Checklist for a Review Engagement**

	AR Ref *	Initials
1. Obtain an engagement letter. ....	.08	_____
2. Determine whether your firm is independent, if the firm is not, go to step 3. If the firm is, go to step 4. ....	.38	_____
3. Stop. Do not issue a review report. (However, it may be possible to issue a compilation report.) ....	.38	_____
4. Acquire the necessary knowledge of the client's industry accounting principles and practices. ....	.24	_____
5. Acquire a general understanding of the nature of the client's business, including (a) its operating characteristics and (b) the nature of its assets, liabilities, revenues, and expenses. ....	.26	_____
6. Apply appropriate inquiry and analytical procedures in order to obtain a reasonable basis for expressing limited assurance that there are no material modifications that should be made to the financial statements. ....	.24 & .27	_____
7. Read the financial statements to determine whether, based on the information presented, they appear to conform to generally accepted accounting principles (GAAP) or an other comprehensive basis of accounting. Obtain reports of other accountants for subsidiaries, investee, etc., if any. Indicate division of responsibility if reference is made to other accountants. ....	.27	_____
8. Perform additional procedures if information appears to be incorrect, incomplete, or otherwise unsatisfactory. ....	.29	_____
9. Document in your workpapers matters covered in steps 6 and 7 above. Also describe unusual matters that were considered and how they were resolved (step 8). ....	.30	_____
10. Determine whether the inquiry and analytical procedures considered necessary to achieve limited assurance are incomplete or restricted in any way. If they are, go to step 11; if not, go to step 12. ....	.36	_____
11. Consider whether a compilation report should be issued rather than a review report. (A review that is incomplete or restricted is not an adequate basis for issuing a review report.) If the client has refused to provide additional or revised information, the accountant should withdraw from the engagement. ....	.12 & .36	_____
12. Consider whether the financial statements contain known departures from GAAP or an other comprehensive basis of accounting, including disclosure departures. If they do, go to step 13. If they do not, go to step 14. ....	.39	_____
13. Get client to revise the financial statements. Failing that, consider modifying your report by adding a separate paragraph or paragraphs. If the impact of the departure has been determined by management or is known by you, disclose the dollar effects in your report. (However, uncertainties and inconsistencies should not cause the report to be modified if they are properly disclosed.) Withdraw from the engagement if the departures are designed to mislead financial statement users. ....	.39 & .40	_____
14. Consider obtaining a representation letter from the client. ....	.31	_____
15. Determine whether the basic financial statements are accompanied by information presented for supplementary analysis purposes. If they are, go to step 16. If they are not, go to step 17. ....	.43	_____
16. Indicate the responsibility assumed for the supplementary information in your review report or in a separate report. The report should disclose whether (a) the supplemental information has been reviewed (as part of the basic financial statement review) and you are not aware of any needed material modification or (b) the supplemental information has not been reviewed but only compiled. ....	.43	_____
17. Mark each page of the financial statements, including any supplemental data, "See accompanying notes and accountant's report." ....	.34	_____
18. Date your report using the date the inquiry and analytical procedures were completed. ...	.33	_____
19. Issue the financial statements and related review report. ....	.32	_____

\* The abbreviation "AR Ref." in this checklist means AR section 100. All references in this checklist are to paragraphs in AR section 100.



- |  | <i>AR<br/>Ref</i> * | <i>Initials</i> |
|--|---------------------|-----------------|
| 20. If subsequent to the date of the report, facts that would possibly cause the financial statements to be misleading are discovered (and were in existence at the report date), consult SAS No. 1, section 561 (AU section 561), Interpretation No. 4 of SSARS No. 1 (AR section 9100.13—.15), and your attorney. .... | .42 *               | _____           |

Completed by \_\_\_\_\_

Date: \_\_\_\_\_

[The next page is 2401.]

---

\* The abbreviation "AR Ref." in this checklist means AR section 100. All references in this checklist are to paragraphs in AR section 100.

# AAM Section 2400

## *Form and Content of Financial Statements*

### Statements Prepared

.01 The basic financial statements for a company that presents its financial statements in accordance with generally accepted accounting principles (GAAP) are:

- Balance Sheet
- Income Statement
- Statement of Cash Flows (either direct or indirect method)
- Statement of Changes in Stockholders' Equity

Examples of financial statement presentations can be found in the AICPA Disclosure Checklist Series.

.02 The description of accounting policies and the notes to the financial statements are considered part of the basic financial statements.

.03 Each financial statement presented should include the name of the company, the applicable statement title, and the date or time period covered. SSARS 1, paragraph 16 (AR section 100.16), states that each page of financial statements compiled by the accountant should contain a reference such as "See Accountant's Compilation Report." Each page of reviewed financial statements should refer to the accountant's review report, as required by SSARS 1, paragraph 34 (AR section 100.34).

.04 When the financial statements are either compiled or reviewed, some accountants prefer to follow the statement title with the word "unaudited." SSARS 1 (AR section 100) does not require use of the word "unaudited" when associated with compiled or reviewed statements nor does it prohibit its use.

### Comparative Financial Statements

.05 There is no requirement to prepare comparative financial statements. However, Accounting Research Bulletin (ARB) No. 43, *Restatement and Revision of Accounting Research Bulletins*, chapter 2, paragraph 1, states that comparative statements in annual and other reports enhance the usefulness of such reports. ARB No. 43 also states that footnotes of the prior year should be repeated, or referred to, to the extent that they continue to be of significance.

.06 When comparative financial statements are presented, the accountant should issue an appropriate report for each period presented in accordance with SSARS 2 (AR section 200). Comparative financial statements may contain statements for which the level of service provided in each period is different. Many times the level of service is indicated in the statement title as follows:

ABC COMPANY  
BALANCE SHEETS  
As of December 31, 19X2 (Reviewed) and 19X1 (Compiled)

.07 Illustrative reports on comparative financial statements can be found in AAM sections 10,400.12—.17 and 10,500.07—.12.

### Notes to Financial Statements

.08 The notes to the financial statements, as a part of the basic statements, are the responsibility of management. The accountant should explain the statements and the footnotes to the client so that the client

understands the statements in sufficient depth to take full responsibility for them. The practitioner who assists the client in preparing the financial statements or who totally prepares them must be careful in the wording of the notes. The accountant should avoid wording the notes in such a way as would imply that they are the responsibility of the accountant. For example, words such as “we,” “our,” and “the client,” should be avoided. When referring to the client, some accountants prefer to use the terms “the Company” or “Management.”

.09 All of the disclosures required by GAAP should be made either on the face of the financial statements or in the notes thereto. In a compilation engagement, the client may elect to omit substantially all disclosures; a more detailed discussion of this appears in AAM section 2500. For a list of required disclosures, the accountant and the client may wish to review the applicable AICPA disclosure checklists.

## Supplementary Information

.10 The accountant’s report on supplementary information is discussed in SSARS 1, paragraph 43 (AR section 100.43), which states that when the basic financial statements are accompanied by information presented for supplementary analysis purposes, the accountant should clearly indicate the degree of responsibility he is taking regarding the other information. The supplementary information is generally separated from the basic financial statements and many accountants believe it should be presented after the basic statements.

.11 When the accountant compiles both the basic financial statements and the other data presented for supplementary analysis purposes only, his or her compilation report should include the supplementary information.

.12 When the accountant has reviewed the basic financial statements, he may indicate the degree of responsibility he is taking with respect to the other information by an explanation in his review report or in a separate report on the other data, that the review has been made for the purpose of expressing limited assurance that there are no material modifications that should be made to the financial statements for them to be in conformity with GAAP, and either—

- a. The other data accompanying the financial statements are presented for supplementary analysis purposes only and have been subjected to the inquiry and analytical procedures applied in the review of the financial statements, and the accountant did not become aware of any material modifications that should be made to such data, or
- b. The other data accompanying the financial statements are presented for supplementary analysis purposes and have not been subjected to the inquiry and analytical procedures applied in the review of the financial statements, but were compiled from information that is the representation of management, without audit or review, and the accountant does not express an opinion or any other form of assurance on such data.

.13 Illustrative accountants’ reports on supplementary information accompanying compiled and reviewed financial statements can be found in AAM sections 10,400.18 and 10,500.13—.14, respectively.

## Subsequent Discovery of Facts

.14 Subsequent to the report date for compiled or reviewed financial statements the accountant may become aware of facts that may have existed at the report date which might have caused the accountant to believe that information supplied by the client was incorrect, incomplete, or otherwise unsatisfactory. SSARS 1, paragraph 42 (AR section 100.42), states that, in those circumstances, the accountant may wish to consider the guidance in SAS No. 1, section 561, *Subsequent Discovery of Facts Existing at the Date of the Auditor’s Report* (AU section 561), in determining the proper course of action.

.15 Interpretation 4 of SSARS 1, “Discovery of Information After the Date of the Accountant’s Report” (AR section 9100.13—.15), discusses two factors the accountant might consider when determining the appropriate course of action regarding the subsequent discovery. The two factors discussed are (1) the reliability of the

information and (2) the existence of persons known to be relying on or likely to rely on the financial statements. If the accountant determines that the information is reliable and there are persons known to be relying on or likely to rely on the information, the accountant would ordinarily conclude that those individuals should be notified in an appropriate manner.

.16 Both SSARS 1, paragraph 42 (AR section 100.42) and Interpretation 4 (AR section 9100.13—.15) indicate that because of the legal implications involved in actions contemplated under SAS No. 1, section 561 (AU section 561), and Interpretation 4 discussed in paragraphs .14 and .15, the accountant should consider consulting an attorney.

---

[The next page is 2501.]



# AAM Section 2500

## *Accountants' Reports*

.01 The users of financial statements should be able to easily identify the degree of responsibility that an accountant is taking with respect to a specific set of financial statements. The usual method of conveying the amount of responsibility taken is the written accountant's report. Therefore, whenever an accountant reviews or compiles financial statements, he should issue a report prepared in accordance with the statements on standards for accounting and review services.

.02 According to SSARS 1, paragraph 6 (AR section 100.06), an accountant should not consent to the use of his name in a document or written communication containing unaudited financial statements unless

- a. he has compiled or reviewed the financial statements and his report accompanies them, or
- b. the financial statements are accompanied by an indication that the accountant has not compiled or reviewed the financial statements and that he assumes no responsibility for them.

.03 If an accountant becomes aware that his name has been improperly used in a client-prepared document containing unaudited financial statements, he should advise his client that use of his name is inappropriate. The accountant should consider what other courses of action need to be taken, including consulting with his or her attorney.

.04 An accountant should not submit unaudited financial statements to his client or third parties unless, as a minimum service, he has compiled the financial statements in accordance with statements on standards for accounting and review services.

.05 If the accountant has performed more than one service, he should issue the report which is appropriate for the highest level of service performed. For example, if an accountant performs both a compilation and an audit of financial statements, the appropriate report to issue would be the audit report.

### **Compilation Report**

.06 SSARS 1, paragraph 14 (AR section 100.14), states that financial statements compiled by an accountant should be accompanied by a report that states—

- a. A compilation has been performed in accordance with standards established by the American Institute of Certified Public Accountants.
- b. A compilation is limited to presenting in the form of financial statements information that is the representation of management.
- c. The financial statements have not been audited or reviewed and, accordingly, the accountant does not express an opinion or any other form of assurance on them.

Any other procedures performed by the accountant either before or during the compilation engagement should not be described in the accountant's report. An example of the accountant's standard compilation report can be found in AAM section 10,400.01.

.07 Each page of the financial statements compiled by the accountant should include a reference to the accountant's report, such as, "See Accountant's Compilation Report."

.08 The date of the completion of the compilation should be used as the date of the accountant's report.

.09 An accountant may be asked to issue a compilation report on only one financial statement and not on the other related financial statements, for example, reporting on the balance sheet, but not on the related statements of income, retained earnings, and cash flows. SSARS 1 (AR section 100) does not prohibit the accountant from performing such a service.

.10 If an accountant is not independent, he may still issue a compilation report, provided that he has followed the appropriate authoritative literature during his engagement. The accountant should disclose his lack of independence; however, the reason should not be described. The following statement should be included as the last paragraph of his report:

I am (we are) not independent with respect to XYZ Company.

## Review Report

.11 SSARS 1, paragraph 32 (AR section 100.32), states that financial statements reviewed by an accountant should be accompanied by a report which states—

- a. A review has been performed in accordance with standards established by the American Institute of Certified Public Accountants.
- b. All information included in the financial statements is the representation of management of the entity.
- c. A review consists principally of inquiries of company personnel and analytical procedures applied to financial data.
- d. A review is substantially less in scope than an audit, the objective of which is the expression of an opinion regarding the financial statements taken as a whole and, accordingly, no such opinion is expressed.
- e. The accountant is not aware of any material modifications that should be made to the financial statements in order for them to be in conformity with generally accepted accounting principles (GAAP), other than those modifications, if any, indicated in his report.

Any other procedures performed by the accountant either before or during the review engagement should not be described in the accountant's report. An example of the accountant's standard review report can be found in AAM section 10,500.01.

.12 Each page of the financial statements reviewed by the accountant should include a reference to the accountant's report, such as, "See Accountant's Review Report."

.13 The date of the completion of the accountant's inquiry and analytical procedures should be used as the date of the accountant's report.

.14 If an accountant is unable to perform the necessary inquiry and analytical procedures to achieve the limited assurance which is contemplated by a review, then his review is incomplete. Therefore, he would not have an adequate basis for issuing a review report. If this is the case, then the accountant should consider whether in this situation the incomplete review also precludes him from issuing a compilation report on the financial statements. A change in the level of service is discussed in AAM section 2200.07 through .16.

.15 An accountant may be asked to issue a review report on only one financial statement and not on the other related financial statements, for example, reporting on the balance sheet, but not on the related statements of income, retained earnings, and cash flows. According to SSARS 1, paragraph 37 (AR section 100.37), the accountant may do so as long as the scope of his analytical procedures has not been limited.

.16 SSARS 1, paragraph 38 (AR section 100.38), precludes the accountant from issuing a review report for an entity with respect to which the accountant is not independent.

## Modifications to Standard Report

### Omission of Substantially All Disclosures

.17 SSARS 1, paragraphs 19 through 21 (AR section 100.19—.21), discuss reporting on financial statements that omit substantially all disclosures. An accountant may compile financial statements that omit substantially all disclosures required by GAAP, provided that this omission is clearly indicated in his report, and is not, to the accountant's knowledge, undertaken with the intention to mislead the user of the financial statements. Examples of the appropriate reports under these circumstances can be found in AAM section 10,400.02—.03.

.18 If the entity wants to include disclosures about only a few matters in the form of notes to the financial statements, then that information should be clearly labeled as selected information, i.e., "Selected Information—Substantially All Disclosures Required by Generally Accepted Accounting Principles Are Not Included."

.19 If the financial statements are compiled in accordance with a comprehensive basis of accounting other than GAAP and disclosure is not made of the basis used, then the basis should be disclosed in the accountant's report.

### Omission of Statement of Cash Flows

.20 FASB Statement No. 95, *Statement of Cash Flows*, paragraph 3, requires that a business enterprise that provides a set of financial statements that reports both financial position and results of operations should include a statement of cash flows for each period for which results of operations are reported. Therefore, omitting this statement is a departure from GAAP. A GAAP departure must be disclosed in a separate paragraph of the accountant's report. If the statement of cash flows is omitted, then the following paragraph should be added to the accountant's compilation or review report:

A statement of cash flows for the year ended December 31, 19XX, has not been presented.  
Generally accepted accounting principles require that such a statement be presented when financial statements purport to present financial position and results of operation.

The first paragraph of the report should also be modified accordingly. Examples of the full accountant's reports, both compilation and review, can be found in AAM sections 10,400.03 and 10,500.04, respectively.

### GAAP Departures

.21 An accountant who is engaged to compile or review financial statements may become aware of a GAAP departure which is material to the financial statements taken as a whole. The accountant should ask management to revise the financial statements. If management refuses to revise the financial statements, then the accountant should consider whether modification of his standard report is sufficient to disclose the departure.

.22 SSARS 1, paragraph 40 (AR section 100.40), states that if the accountant decides that modification of the standard report is appropriate, then the departure should be disclosed in a separate paragraph of his report. This disclosure should include the effects of the departure on the financial statements if management has determined these effects, or as part of the procedures performed the accountant has been able to determine the effects himself. The accountant is not required to determine the effects if management has not done so and this is clearly stated in his report. Examples of both compilation and review reports can be found in AAM sections 10,400.05—.06 and 10,500.02—.04, respectively.

.23 If the accountant believes that modification of the standard compilation or review report is not sufficient to indicate the deficiencies of the financial statements taken as a whole, then according to SSARS 1, paragraph 41 (AR section 100.41), the accountant should withdraw from the engagement and provide no further services with respect to that set of financial statements. The accountant may also want to contact his attorney.



## Scope Limitations

.24 According to SSARS 1, paragraph 36 (AR section 100.36), if an accountant is unable to perform the necessary inquiry and analytical procedures to achieve the limited assurance which is contemplated by a review, then his review is incomplete. Therefore, he would not have an adequate basis for issuing a review report. If this is the case, then the accountant should consider whether in this situation the incomplete review also precludes him from issuing a compilation report on the financial statements.

.25 The decision to issue a compilation report under these circumstances is a matter of professional judgment. Interpretation No. 14 of SSARS 1, "Reporting on Financial Statements When the Scope of the Accountant's Procedures Has Been Restricted" (AR section 9100.50—.53), offers guidance on making this judgment.

.26 Interpretation No. 14 (AR section 9100.50—.53) says that the accountant should consider whether the client has refused to provide additional information or make requested revisions, or the client is unable to provide such information because of circumstances beyond his control. If a client refuses to furnish this additional information, then according to SSARS 1, paragraph 12 (AR section 100.12), the accountant should withdraw from the engagement.

.27 If the client is unable to provide the information because of circumstances beyond his control, the accountant should consider the reasons for the limitation. Before deciding to issue a compilation report he should also consider the impact of the limitation on the usefulness of the financial statements. If the accountant decides to issue a compilation report under these circumstances, he should consider adding an explanatory paragraph that describes the nature of the limitation.

## Uncertainties

.28 Interpretation No. 11 of SSARS 1, "Reporting on Uncertainties" (AR section 9100.33—.40), offers guidance on the accountant's reporting obligations when there is an uncertainty in the financial statements. Disclosure guidelines for uncertainties can be found in FASB Statement No. 5, *Accounting for Contingencies* (AC C59), and FASB Statement No. 47, *Disclosure of Long-Term Obligations* (AC C32).

.29 The accounting literature does not provide any guidance concerning the necessary disclosures for an uncertainty caused by doubts about an entity's ability to continue as a going concern. This guidance is found in SAS No. 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern*, paragraphs 10 and 11 (AU section 341.10—.11).

.30 If the accountant believes that the disclosure of an uncertainty in the financial statements is inadequate, then he should look to the guidance on reporting on GAAP departures, AAM section 2500.21—.23, for the necessary modifications to his report. If the accountant believes that the disclosure of an uncertainty in the financial statements is adequate, then according to SSARS 1, paragraph 40, footnote 14 (AR section 100.40), there is no need to modify the accountant's standard report, either compilation or review.

.31 Although it is not required, an accountant may wish to add an explanatory paragraph to his compilation or review report to emphasize the existence of an uncertainty. An example of an explanatory paragraph follows:

As discussed in Note X, certain conditions indicate that the Company may be unable to continue as a going concern. The accompanying financial statements do not include any adjustments to the financial statements that might be necessary should the Company be unable to continue as a going concern.

Examples of full compilation and review reports for this situation can be found in AAM sections 10,400.21 and 10,500.15, respectively.

---

[The next page is 2601.]

# AAM Section 2600

## *Special Areas*

### Prescribed Forms

.01 SSARS 3 (AR section 300) allows an accountant to issue a compilation report on a prescribed form which calls for a departure from GAAP by using a measurement principle different from GAAP or by not requiring the disclosures required by GAAP. A prescribed form is defined in SSARS 3, paragraph 2 (AR section 300.02), as “any standard preprinted form designed or adopted by a body to which it is to be submitted, for example, forms used by industry trade associations, credit agencies, banks, and governmental and regulatory bodies other than those concerned with the sale or trading of securities.”

.02 Generally, it is assumed that the information required by a prescribed form meets the needs of the body that required the form to be completed, and, therefore, it is not necessary for that body to be advised of departures from GAAP that are required by the form. An example of the compilation report to be issued when the unaudited financial statements of a nonpublic entity are included in a prescribed form that calls for departures from GAAP can be found in AAM section 10,400.19.

.03 If, during the compilation engagement, the accountant becomes aware of a departure from GAAP not required by the prescribed form, he should follow the guidance discussed in AAM section 2500.21 through .23 on GAAP departures. If the accountant finds that there is a departure from the requirements of the prescribed form, he should consider the departure the same as he would a departure from GAAP in determining the effects on his report. An example of a compilation report for a departure from GAAP which was not called for by the prescribed form can be found in AAM section 10,400.20.

.04 SSARS 3, paragraph 5 (AR section 300.05), states that if the accountant is asked to sign a preprinted form which does not conform with the guidance found in SSARS 3 (AR section 300) or SSARS 1 (AR section 100), he should not sign the form. He should add the appropriate report to the prescribed form.

### Specified Elements

.05 SSARS 1 (AR section 100) provides guidance on the compilation and review of financial statements. Some accountants are asked to issue review reports on separate presentations of specified elements, accounts or items of financial statements or to report on agreed-upon procedures. Since this type of presentation is not a financial statement, guidance for this type of engagement is not found in the statements on standards for accounting and review services. This type of presentation should be reported on in accordance with SAS No. 14, *Special Reports* (AU section 621), and SAS No. 35, *Special Reports—Applying Agreed-Upon Procedures to Specified Elements, Accounts, or Items of a Financial Statement* (AU section 622).

---

[The next page is 3001.]



## AAM Section 3000

# ENGAGEMENT PLANNING AND ADMINISTRATION

Sections 3165, 3170, and 3175 include illustrative audit assignment control forms, engagement letters, and an illustrative planning checklist that can be used by an accountant in the planning phase of an audit engagement.

Various formats of audit assignment controls, engagement letters, and planning checklists are in use; nevertheless, inclusion of the formats in this section in no way means that they are preferable. Readers are urged to refer directly to authoritative pronouncements when appropriate.

Illustrative formats of audit assignment controls, engagement letters, and planning checklists are often helpful in developing a consistent style within a firm. However, no set of illustrative formats can cover all the situations that are likely to be encountered in practice because the circumstances of engagements vary widely.

Readers should consider other sources of illustrative presentations, such as those in authoritative pronouncements and AICPA audit and accounting guides.

## TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
3100	Planning the Engagement . . . . .	.01-.06
3105	Understanding the Assignment . . . . .	.01-.02
3110	Assigning Personnel to the Engagement . . . . .	.01-.08
	General Comments . . . . .	.01-.02
	Engagement Planning Procedures . . . . .	.03-.08
3115	Independence . . . . .	.01-.08
	General Comments . . . . .	.01-.03
	Engagement Planning Procedures . . . . .	.04-.08
3120	Knowledge of the Entity's Business . . . . .	.01-.06
	Engagement Planning Procedures . . . . .	.02-.06
3125	Assessing Auditability . . . . .	.01-.18
	Adequate Accounting Records . . . . .	.02-.07
	SAS No. 55 Requirements . . . . .	.05-.07
	Understanding the Internal Control Structure . . . . .	.08
	Understanding of Control Environment . . . . .	.09
	Understanding of Accounting System . . . . .	.10
	Understanding of Control Procedures . . . . .	.11
	Procedures to Obtain Understanding . . . . .	.12
	Documentation of Understanding . . . . .	.13
	Management Integrity . . . . .	.14-.18
3130	Preparing an Engagement Letter . . . . .	.01-.19
	Reasons for Engagement Letters . . . . .	.06-.07
	Special Considerations . . . . .	.08
	Contents of Engagement Letters . . . . .	.09-.12
	Client Approval . . . . .	.13

<i>Section</i>	<i>Paragraph</i>
3130 Preparing an Engagement Letter—continued	
Addressee of Letter . . . . .	.14
Investigatory Procedures for Individuals . . . . .	.15-.16
Filing of Engagement Letters . . . . .	.17-.19
3135 Assessment of Control Risk . . . . .	.01-.15
General Comments . . . . .	.01
Consideration of the Internal Control Structure in Assessing Control Risk . . . . .	.02-.10
Documentation of the Assessed Level of Control Risk . . . . .	.11
Further Reduction in the Assessed Level of Control Risk . . . . .	.12-.15
3140 Assessing Audit Risk and Materiality . . . . .	.01-.22
Audit Risk . . . . .	.02-.03
Risk Components . . . . .	.04-.09
Risk Assessment and Planning . . . . .	.10
Quantifying Risk . . . . .	.11-.13
Materiality . . . . .	.14-.15
In Planning . . . . .	.16
Quantifying Materiality . . . . .	.17-.19
Example . . . . .	.20-.22
3145 Errors and Irregularities . . . . .	.01-.18
General Comments . . . . .	.01-.02
Consideration of Audit Risk at the Financial Statement Level . . . . .	.03-.06
The Auditor's Response to Risk at the Financial Statement Level . . . . .	.07-.09
Consideration of Audit Risk at the Balance or Class Level . . . . .	.10
Professional Skepticism . . . . .	.11-.12
Professional Skepticism in Audit Planning . . . . .	.13-.18
3150 Illegal Acts . . . . .	.01-.11
General Comments . . . . .	.01-.02
Direct and Material Effect Illegal Acts . . . . .	.03-.05
Other Illegal Acts . . . . .	.06-.07
Engagement Planning Procedures . . . . .	.08-.11
3155 Analytical Procedures . . . . .	.01-.07
General Comments . . . . .	.01-.03
Engagement Planning Procedures . . . . .	.04-.07
3160 Audit Strategies and the Audit Program . . . . .	.01-.02
3165 Illustrative Planning Checklist . . . . .	.01-.09
A. Understanding the Assignment . . . . .	.01
B. Assigning Personnel to the Engagement . . . . .	.02
C. Independence . . . . .	.03
D. Knowledge of the Entity's Business . . . . .	.04
E. Assessing Auditability . . . . .	.05
F. Engagement Letter . . . . .	.06
G. Assessing Audit Risk and Materiality . . . . .	.07
H. Assessment of Control Risk . . . . .	.08
I. Errors and Irregularities . . . . .	.09
J. Illegal Acts . . . . .	.10
K. Analytical Procedures . . . . .	.11
L. Audit Strategies and the Audit Program . . . . .	.12
3170 Audit Assignment Controls . . . . .	.01-.05
Audit Time Budget—Sample A . . . . .	.01
Audit Time Budget—Sample B . . . . .	.02
Audit Time Analysis (Short Form) . . . . .	.03
Audit Time Analysis (Long Form) . . . . .	.04

<i>Section</i>	<i>Paragraph</i>
3170 Audit Assignment Controls—continued	
Weekly Progress Report .....	.05
3175 Sample Engagement Letters .....	.01-.12
Audit Engagement Leading to Opinion .....	.02
Audit Engagement Leading to Opinion (Including Financial Information for Form 10-K) .....	.03
Change in Circumstances From Those Contemplated in Original Engagement Letter .....	.04
Conditions Encountered Which Do Not Permit Expression of Opinion as Anticipated in Original Engagement Letter .....	.05
SEC Engagement: Initial Registration, Form S-1 .....	.06
Compilation of Financial Statements and Tax Services .....	.07
Review of Financial Statements and Tax Services .....	.08
Sample Engagement Memorandum (When No Formal Engagement Letter Is Sent) .	.09
Audits of Personal Financial Statements .....	.10
Compilation of Personal Financial Statements .....	.11
Review of Personal Financial Statements .....	.12

---

[The next page is 3101.]



# AAM Section 3100

## *Planning the Engagement*

.01 The planning phase is an important part of every engagement. During this phase, the partner and the staff review the client's business and the industry in which the client operates, then develop an overall strategy for the expected conduct and scope of the engagement.

.02 The need for planning is highlighted in Rule 201, General Standards (ET section 201.01), AICPA Code of Professional Conduct, which states: "A member shall adequately plan and supervise an engagement."

.03 The first standard of fieldwork of generally accepted auditing standards states: "The work is to be adequately planned and assistants, if any, are to be properly supervised." Statement on Auditing Standards (SAS) No. 22, *Planning and Supervision* (AU section 311), provides authoritative interpretive guidance on the first standard of fieldwork.

.04 Proper planning also enhances the productivity of engagement personnel and should result in a more profitable engagement.

.05 The planning memo and the planning checklist are two commonly used planning documents. The style and complexity of these documents will depend on engagement needs and firm preference. The same memo or checklist may be referred to in the review process to ensure that the items highlighted in the planning phase are given adequate attention during the engagement.

.06 The steps in audit planning are as follows:

- a. Understand the scope of services and the nature of reports expected to be rendered.
- b. Decide whether or not to accept the engagement.
- c. Assign personnel to the engagement and prepare a preliminary time budget.
- d. Assess independence of firm and audit team.
- e. Understand the entity's business and the industry in which it operates.
- f. Assess the auditability of the entity by—
  1. Gaining an adequate understanding of the internal control structure.
  2. Evaluating management integrity.
- g. Establish an agreement with the client, preferably with an engagement letter.
- h. Assess control risks.
- i. Make a preliminary judgment about materiality levels for audit purposes.
- j. Estimate the level of audit risk and consider its interactive components.
- k. Consider how components of audit risk relate to one another for each cycle or major account.
- l. Consider cost-effectiveness of different audit strategies.
- m. Write the audit program and finalize a time budget.

---

[The next page is 3121.]





# AAM Section 3105

## *Understanding the Assignment*

.01 The auditor should (a) meet with the client to understand the type, scope, and timing of the engagement; (b) understand if reports on compliance, internal control structure, or segments of the entity are required; (c) understand the client's expectations, both stated and implied; and (d) review the expectations of both the owners and managers.

.02 A sample checklist documenting the procedures listed in this section is located in AAM section 3165.

---

[The next page is 3141.]



# AAM Section 3110

## *Assigning Personnel to the Engagement*

### General Comments

.01 Engagement planning should include procedures for assigning personnel to the engagement. The procedures established should provide the firm with reasonable assurance that work will be performed by persons having the degree of technical training and proficiency required in the circumstances. Generally, the more able and experienced the personnel assigned to a particular engagement, the less need for direct supervision.

.02 Some procedures regarding assignment of personnel to the engagement are discussed in this section. The specific procedures adopted by a firm would not necessarily include all the procedures or be limited to those discussed. Overall firm requirements for assigning personnel to engagements are addressed in the *Quality Control Policies and Procedures for CPA Firms*, "Establishing Quality Control Policies and Procedures," (QC section 90), paragraphs .11—.12.

### Engagement Planning Procedures

.03 A time budget for the engagement should generally be prepared to determine manpower requirements and to schedule field work. The engagement partner should approve the time budget prior to the beginning of field work. A time budget should have columns for budgeted time (in hours) for preliminary and final field work. Time budget forms differ depending upon firm preference and needs. Some firms use separate forms for the time budget report and the job progress report or analysis (see AAM section 3170.01 for "Audit Time Budget—Sample A"), whereas others combine these reports into one form (see AAM section 3170.02 for "Audit Time Budget—Sample B").

.04 Other alternatives include longer, more detailed sets of forms. These forms combine the features of a time budget, a source document for staff scheduling, and a job progress report that compares each assigned person's actual daily hours against the budget. Some firms use a shorter, less detailed form for jobs of less than a pre-determined number of staff hours (for example, one hundred hours; see AAM section 3170.03 for "Audit Time Analysis—Short Form") and a longer form for jobs requiring more time (see AAM section 3170.04 for "Audit Time Analysis—Long Form"). Some firms use a weekly (or daily) progress report (see AAM section 3170.05, for example). This report, submitted by the accountant in charge, shows the time actually spent in relation to the estimate, the estimated additional time required, and the estimated variance from the original estimate.

.05 When the combined time budget and progress report form (sample B) is used, it must be kept current as the assignment progresses. This form is carried in the working papers file and is filled in daily by the accountant in charge, for all persons applying time on the engagement. This procedure is vital to identify and control time as it is applied so that it can be compared to the budgeted time for that phase of the engagement.

.06 The following factors should be considered in achieving a balance of engagement manpower requirements, personnel skills, individual development, and utilization:

- a. Engagement size and complexity
- b. Personnel availability
- c. Special expertise
- d. Timing of the work to be performed
- e. Continuity and periodic rotation of personnel

*f.* Opportunities for on-the-job training

.07 The scheduling and staffing of the engagement should be approved by the partner with final responsibility for the engagement so that the partner can consider the qualifications, experience, and training of personnel to be assigned. The experience and training of the engagement personnel should be considered in relation to the complexity or other requirements of the engagement and the extent of supervision to be provided.

.08 It is recommended that all procedures discussed in this section be documented in the accountant's work papers. A sample checklist documenting the procedures listed in this section is located in AAM section 3165.

---

[The next page is 3161.]

# AAM Section 3115

## *Independence*

### General Comments

.01 Engagement planning should include procedures to provide the firm with reasonable assurance that persons at all organizational levels maintain independence to the extent required by the AICPA Code of Professional Conduct. Interpretation 101-1 of rule 101 of the rules of conduct (ET section 101.02), contains examples of instances wherein a firm's independence will be considered to be impaired.

.02 The procedures employed at the engagement level should be designed to ascertain whether the firm and its partners and employees have complied with all applicable independence rules, with emphasis on those related to financial interest, performance of accounting services for the client, and unpaid fees. Overall firm requirements for independence are addressed in the *Quality Control Policies and Procedures for CPA Firms*, "Establishing Quality Control Policies and Procedures," (QC section 90), paragraphs .09—.10.

.03 Some procedures regarding independence which a firm may employ in the planning phase of an engagement are discussed in this section. The specific procedures adopted by a firm would not necessarily include all these procedures or be limited to those discussed.

### Engagement Planning Procedures

.04 Annual independence questionnaires should be reviewed for all engagement personnel by the engagement partner to assure that those individuals assigned to the engagement are independent.

.05 Accounts receivable from the client should be reviewed to ascertain whether any outstanding amounts take on some of the characteristics of loans and may, therefore, impair the firm's independence.

.06 According to SAS No. 1, section 543, *Part of the Examination Made by Other Independent Auditors* (AU section 543), the firm, when acting as principal auditor, should obtain confirmation of the independence of another firm engaged to perform segments of the audit. Written confirmation enables the principal auditor to document his assessment of the other auditor's independence in his audit work papers.

.07 In situations in which the accountant is not independent, the type of opinion to be issued should be discussed in the planning stage. A disclaimer of opinion should be issued as discussed in SAS No. 26, *Association With Financial Statements*, paragraphs 8—10 (AU section 504.08—.10), or the engagement should be turned into a compilation.

.08 It is recommended that all procedures discussed in this section be documented in the auditor's work papers. A sample checklist documenting the procedures listed in this section is located in AAM section 3165.

---

[The next page is 3181.]



# AAM Section 3120

## *Knowledge of the Entity's Business*

.01 The accountant should obtain a level of knowledge of the entity's business that will enable the accountant to plan and perform the audit in accordance with generally accepted auditing standards. That level of knowledge should enable the accountant to obtain an understanding of the events, and may have a significant effect on the financial statements. The level of knowledge customarily possessed by management relating to managing the entity's business is substantially greater than that which is obtained by the accountant in performing the audit. Knowledge of the entity's business helps the accountant in—

- a. Identifying areas that may need special consideration.
- b. Assessing conditions under which accounting data are produced, processed, reviewed, and accumulated within the operation.
- c. Evaluating the reasonableness of estimates, such as valuation of inventories, depreciation, allowances for doubtful accounts, and percentage-of-completion of long-term contracts.
- d. Evaluating the reasonableness of management representations.
- e. Making judgments about the appropriateness of the accounting principles applied and the adequacy of disclosures.<sup>1</sup>

## **Engagement Planning Procedures**

.02 The accountant should obtain a knowledge of matters that relate to the nature of the entity's business, its organization, and its operating characteristics. Such matters include, for example, the type of business, types of products and services, capital structure, related parties, locations and production, distribution, and compensation methods. The accountant should also consider matters affecting the industry in which the entity operates—such as economic conditions, government regulations, and changes in technology—as they relate to his audit. Other matters, such as accounting practices common to the industry, competitive conditions, and, if available, financial trends and ratios, should also be considered by the accountant.

.03 Knowledge of an entity's business is obtained through performing analytical procedures, prior experience with the entity or its industry, and inquiry of the entity's personnel. Working papers from prior years may contain useful information about the nature of the business, organizational structure, operating characteristics, and transactions that may require special consideration. Other sources an accountant may consult include AICPA audit and accounting guides, industry publications, financial statements of other entities in the industry, textbooks, periodicals, and individuals knowledgeable about the industry.

.04 The accountant should give thought to whether specialized skills are needed to consider the effect of computer processing on the audit, to understand the nature of internal control structure policies and procedures, or to design and perform audit procedures. If specialized skills are needed, the accountant should seek assistance from a professional who may be either on or outside the accountant's staff. If the use of such a professional is planned, the accountant should have sufficient computer-related knowledge to communicate the objectives of the other professional's work, to evaluate whether the specified procedures will meet the accountant's objectives, and to evaluate the results of the procedures applied as they relate to the nature, timing, and extent of other planned

---

<sup>1</sup> See SAS No. 5, *The Meaning of "Present Fairly in Conformity With Generally Accepted Accounting Principles" in the Independent Auditor's Report*, paragraphs 4 and 9 (AU section 411.04 and .09).



audit procedures. The accountant's responsibilities for using such a professional are equivalent to those for using assistants.<sup>2</sup>

.05 The accountant should consider the methods the entity uses to process accounting information in planning the audit because such methods influence the design of the accounting system and the nature of control procedures. The extent to which computer processing is used in significant accounting applications, as well as the complexity of that processing, may also influence the nature, timing, and extent of audit procedures. Accordingly, when evaluating the effect of an entity's computer processing on an audit of financial statements, the accountant should consider matters such as—

- a. The extent to which the computer is used in each significant accounting application.
- b. The complexity of the entity's computer operations, including the use of an outside service center.<sup>3</sup>
- c. The organizational structure of the computer processing activities.
- d. The availability of data. Documents that are used to enter information into the computer for processing certain computer fields, and other evidential matter that may be required by the accountant, may exist only for a short period or only in computer-readable form. In some computer systems, input documents may not exist at all because information is entered directly into the system. An entity's data retention policies may require the accountant to request retention of some information for the review or to perform audit procedures at a time when the information is available.
- e. The use of computer-assisted audit techniques to increase the efficiency of performing audit procedures.<sup>4</sup> Using computer-assisted audit techniques may also provide the accountant with an opportunity to apply certain procedures to an entire population of accounts or transactions. In addition, in some accounting systems, it may be difficult or impossible for the auditor to analyze certain data or test specific control procedures without computer assistance.

In addition, certain information generated by the computer for management's internal purposes may be useful in performing substantive tests (particularly analytical procedures).<sup>5</sup>

.06 It is recommended that all procedures discussed in this section be documented in the accountant's work papers. A sample checklist for documenting the procedures listed in this section is located in AAM section 3165.

---

[The next page is 3201.]

---

<sup>2</sup> Since the use of a specialist who is effectively functioning as a member of the audit team is not covered by SAS No. 11, *Using the Work of a Specialist* (AU section 336), a computer audit specialist requires the same supervision and review as any assistant.

<sup>3</sup> See SAS No. 44, *Special-Purpose Reports on Internal Accounting Control at Service Organizations* (AU section 324), and the related AICPA Audit and Accounting Guide, *Audits of Service-Center-Produced Records*, for guidance concerning the use of a service center for computer processing of significant accounting applications.

<sup>4</sup> See the AICPA Audit and Accounting Guide, *Computer-Assisted Audit Techniques*, for guidance relating to this specialized area.

<sup>5</sup> SAS No. 56, *Analytical Procedures* (AU section 329), describes the usefulness of and guidance pertaining to such procedures.

# AAM Section 3125

## Assessing Auditability

.01 The third standard of fieldwork requires that the auditor obtain sufficient competent evidential matter to afford a reasonable basis for the expression of an opinion on whether an entity's financial statements are fairly presented in conformity with generally accepted accounting principles.<sup>1</sup> The determination of whether the auditor is able to obtain sufficient competent evidential matter to issue an opinion on the financial statements is an issue of auditability. Many factors can influence the auditability of financial statements. There are two primary considerations, however, in evaluating whether the financial statements of a small business are, in fact, auditable: (1) the adequacy of accounting records and (2) management integrity.

### Adequate Accounting Records

.02 To provide sufficient competent evidential matter, an entity's accounting system should be designed to identify the types of transactions executed so that the transactions can be recorded in the appropriate amounts in the correct accounting period. Accounting records should include the following information:

- a. *Type of transaction.* Transactions should be described in sufficient detail to permit appropriate classification in the financial statements. Generally, accounting records need only indicate broad classes of transactions such as sales or payroll. In some circumstances, however, a more detailed description may be necessary, such as when payroll costs are to be allocated between inventory and expense. Identification of the type of transaction may be either explicit (for example, by using preprinted forms that describe the type of transactions, such as sales invoices) or implicit (for example, by using cash register tapes as a record of cash sales).
- b. *Size of transaction.* Transactions should be described in a manner that permits the recording of monetary value in the financial statements. Although accounting records generally include the dollar amount of transactions or the quantities involved and related unit prices, an indication of quantities only may be sufficient if the monetary value of transactions can be determined by reference to data such as price lists, wage rates, or contracts.
- c. *Period of time.* Accounting records should include the period in which the transactions occurred to permit the recording of transactions in the appropriate accounting period.

.03 The form of accounting records maintained by the client and the detail in which they are prepared varies because of a number of factors, such as the nature of the client's business, its size, and its organizational structure. For a small business to be auditable, there should exist adequate accounting records to identify the types of transactions executed and to record them at the appropriate amount in the correct accounting period.

.04 Many small businesses do not have elaborate accounting systems. Likewise, most small businesses have neither adequate segregation of duties nor a sophisticated internal control structure. Neither a formalized and complex accounting system nor a sophisticated control structure is required for a small business to be auditable.

### SAS No. 55 Requirements

.05 The auditor should obtain a sufficient understanding of each of the three elements (control environment, accounting system, and control procedures) of the entity's internal control structure to plan the audit of the entity's financial statements. The understanding should include knowledge about the design of relevant policies, proce-

<sup>1</sup> Throughout this section, references to audit opinions regarding generally accepted accounting principles also include other comprehensive bases of accounting.

dures, and records and whether they have been placed in operation by the entity. In planning the audit, such knowledge should be used to:

- a. Identify types of potential misstatements.
- b. Consider factors that affect the risk of material misstatement.
- c. Design substantive tests.

.06 Whether an internal control structure policy or procedure has been placed in operation is different from its operating effectiveness. In obtaining knowledge about whether policies and procedures have been placed in operation, the auditor determines that the entity is using them. Operating effectiveness, on the other hand, is concerned with how the policy, procedure, or record was applied, the consistency with which it was applied, and by whom. The auditor is not required to obtain knowledge about operating effectiveness as part of the understanding of the internal control structure used in planning the audit.

.07 The auditor's understanding of the internal control structure may sometimes raise doubts about the auditability of an entity's financial statements. Concerns about the integrity of the entity's management may be so serious as to cause the auditor to conclude that the risk of management misrepresentation in the financial statements is such that an audit cannot be conducted. Concerns about the nature and extent of an entity's records may cause the auditor to conclude that it is unlikely that sufficient competent evidential matter will be available to support an opinion on the financial statements.

## Understanding the Internal Control Structure

.08 In making a judgment about the understanding of the internal control structure necessary to plan the audit, the auditor considers the knowledge obtained from other sources about the types of misstatements that could occur, the risk that such misstatements may occur, and the factors that influence the design of substantive tests. Other sources of such knowledge include previous audits and the understanding of the industry in which the entity operates. The auditor also considers his assessment of inherent risk, his judgment about materiality, and the complexity and sophistication of the entity's operations and systems as discussed in AAM section 3140.

## Understanding of Control Environment

.09 The auditor should obtain sufficient knowledge of the control environment to understand management's attitude, awareness, and actions concerning the control environment. The auditor should concentrate on the substance of management's policies, procedures, and related actions rather than their form because management may establish appropriate policies and procedures but not act on them. The auditor must be knowledgeable about the entity's organizational structure. Although there are obviously limits on the formality of organization in a small business, some segregation of duties and designation of authority and responsibility generally can be accomplished. In addition, someone is responsible for engaging the auditor, responding to audit results, and exercising financial reporting oversight. How employees are told what is expected of them, how they are delegated authority and responsibility, and how their performances are monitored and evaluated also affect control consciousness in an entity. In addition, the planning and reporting system used, such as budgeting and forecasting, and personnel management practices are indications of attitudes and actions about internal control. Auditors should know how management has acted on these matters.

## Understanding of Accounting System

- .10 The auditor should obtain sufficient knowledge of the accounting system to understand:
- a. The classes of transactions in the entity's operations that are significant to the financial statements.
  - b. How those transactions are initiated.

- c. The accounting records, supporting documents, machine-readable information, and specific accounts in the financial statements involved in the processing and reporting of transactions.
- d. The accounting processing involved from the initiation of a transaction to its inclusion in the financial statements, including how the computer is used to process data.
- e. The financial reporting process used to prepare the entity's financial statements, including significant accounting estimates and disclosures.

## Understanding of Control Procedures

.11 Generally, control procedures pertain to the proper authorization of transactions, segregation of duties, design and use of adequate documents and records, safeguards over assets and records and independent checks on performance, such as reconciliations, comparing documents, and management review of reports. Because some control procedures are integrated in specific components of the control environment and accounting system, as the auditor obtains an understanding of the control environment and accounting system, he is also likely to obtain knowledge about some control procedures. For example, in obtaining an understanding of the documents, records, and processing steps in the accounting system that pertain to cash, the auditor is likely to become aware of whether bank accounts are reconciled. The auditor should consider the knowledge about the presence or absence of control procedures obtained from the understanding of the control environment and accounting system in determining whether it is necessary to devote additional attention to obtaining an understanding of control procedures to plan the audit. Ordinarily, audit planning does not require an understanding of the control procedures related to each account balance, transaction class, and disclosure component in the financial statements or to every assertion relevant to those components.

## Procedures to Obtain Understanding

.12 In obtaining an understanding of the internal control structure policies and procedures that are relevant to audit planning, the auditor should perform procedures to provide sufficient knowledge of the design of the relevant policies, procedures, and records pertaining to each of the three internal control structure elements and whether they have been placed in operation. This knowledge is ordinarily obtained through previous experience with the entity and procedures such as inquiries of appropriate management, supervisory, and staff personnel; inspection of entity documents and records; and observation of entity activities and operations. The nature and extent of the procedures performed generally vary from entity to entity and are influenced by the size and complexity of the entity, the auditor's previous experience with the entity, the nature of the particular policy or procedure, and the nature of the entity's documentation of specific policies and procedures. The auditor's assessments of inherent risk and judgments about materiality for various account balances and transaction classes also affect the nature and extent of the procedures performed to obtain the understanding. For example, the auditor may conclude that planning the audit of the prepaid insurance account does not require specific procedures to be included in obtaining the understanding of the internal control structure.

## Documentation of Understanding

.13 The auditor should document the understanding of the entity's internal control structure elements obtained to plan the audit. The form and extent of this documentation is influenced by the size and complexity of the entity, as well as the nature of the entity's internal control structure. For example, documentation of the understanding of the internal control structure of a large complex entity may include flowcharts, questionnaires, or decision tables. For a small business, however, documentation in the form of a memorandum may be sufficient. Generally, the more complex the internal control structure and the more extensive the procedures performed, the more extensive the auditor's documentation should be.

## Management Integrity

.14 Management integrity is an essential component of an audit engagement; without it, conflicts between management and the auditor are inevitable. As Mautz and Sharaf note, without management integrity

No management responses to questions or representations could be given any credence whatever. It is doubtful whether the statements of employees, who must be under management control, could be accepted as in any way useful. Certainly the records and documents under management control would be regarded as completely unreliable.<sup>2</sup>

.15 The auditor should recognize the importance of management integrity and its potential impact on the financial statements. If the auditor has reason to doubt management's integrity, careful consideration should be given to the auditor's ability to express an opinion on the entity's financial statements.

.16 The auditor should also assess the risk that management has misstated the financial statements. SAS No. 53, *The Auditor's Responsibility to Detect and Report Errors and Irregularities*, paragraphs 12 and 16—17 (AU section 316.12 and .16—.17), includes a discussion of management characteristics. AAM section 3145 discusses the assessment of risk of errors and irregularities in audit planning.

.17 Statement of Quality Control Standard No. 1, *System of Quality Control for a CPA Firm*, paragraph 7h (QC section 10.07h), states:

In Acceptance and Continuance of Clients, "Policies and procedures should be established for deciding whether to accept or continue a client in order to minimize the likelihood of association with a client whose management *lacks integrity*."

Suggesting that there should be procedures for this purpose does not imply that a firm vouches for the integrity or reliability of a client, nor does it imply that a firm has a duty to anyone but itself with respect to the acceptance, rejection or retention of clients. However, prudence suggests that a firm be selective in determining its professional relationships."

.18 A sample checklist documenting procedures listed in this section is located in AAM section 3165.

---

[The next page is 3221.]

---

<sup>2</sup> R.K. Mautz and Hussein A. Sharaf, *The Philosophy of Auditing*, American Accounting Association (Sarasota, Fla.: 1961), p. 45.

# AAM Section 3130

## *Preparing an Engagement Letter*

.01 In an engagement letter, the firm and the client indicate their mutual understanding and agree to the nature and terms of the engagement. Engagement letters are a matter of sound business practice rather than a professional requirement. They cover the scope of services rendered and the responsibility the firm assumes. Therefore, they should be prepared with the care exercised in entering into other contracts.<sup>1</sup>

.02 Any limitations the client imposes on the scope of the engagement are specifically stated. Every letter covering audit, compilation, and review services should point out the limitations in the accountant's responsibility for the discovery of fraud and other irregularities.

.03 The engagement letter should also describe the terms of billing and payment. If unusual or extraordinary services are to be performed, the engagement letter should completely describe them.

.04 If the auditor has reason to believe the client may publish all or a portion of an audit report, he should advise the client (preferably in the engagement letter) that firm policy is to read printer's proofs of the report and any other accompanying material. This precaution will protect both the client and accountant against condensation of financial statements, omission of footnotes, erroneous layout, and other errors such as misstatement of figures used in a president's letter, other narrative, or statistics.

.05 An engagement letter should be used for every engagement. A letter need not be issued more often than annually. Thus, interim audits or unaudited financial statement preparation can all be provided for in one annual letter. The letter should be sent to the client in duplicate so that a copy may be signed and returned for the accountant's files. Alternatively, the accountant may decide not to request that the client sign and return a copy of the letter. In that case, the letter should be sent to the client with an additional paragraph stating that, unless the client replies to the contrary, the accountant will assume the client agrees to the arrangements described in the letter. In those rare instances when the accountant decides that even this approach is not suitable, an engagement memorandum should be prepared for the file. This should provide all relevant information that would have been included in an engagement letter.

### **Reasons for Engagement Letters**

.06 The advantages of using engagement letters are summarized below.

- *Type of engagement.* Describe the type of engagement (audit, compilation or review, or other accounting service) to be rendered.
- *Avoiding misunderstandings with the client.* In today's litigious environment an engagement letter is needed for both old and new clients. To avoid misunderstandings, the engagement letter should describe in detail the services to be rendered, the fee, and other terms and conditions of the engagement. Oral agreements may result in differences of recollection or understanding between the accountant and the client, and become completely valueless on the death of either.
- *Avoiding misunderstandings with the staff.* The members of the staff working on the engagement must have a complete understanding of what is required of them. A copy of the engagement letter in the working papers provides them an authoritative reference to supplement their oral instructions. This will eliminate confusion and misunderstanding about the type of engagement to be performed, the date and period covered by the financial statements, and the nature of the report expected to be rendered.

---

<sup>1</sup> Statement on Standards for Accounting and Review Services (SSARS) No. 1, *Compilation and Review of Financial Statements*, paragraph 8 (AR section 100.08), states: "The accountant should establish an understanding with the entity, preferably in writing, regarding the services to be performed."

- *Legal liability.* The engagement letter should establish the scope and nature of the accountant's contractual obligation to the client by setting forth, clearly and specifically, the duties the accountant has agreed to perform. Many adverse consequences may result from failure to obtain a written engagement letter.
- *Practice management.* Generally, the executive (managing) partner reviews an engagement letter before the firm issues it. A timely review may be the vehicle that permits the executive partner to correct or amend the terms of the engagement, review the proposed fee and method of payment, and set up guidelines to minimize possible collection problems.
- *Contractual obligation.* Engagement letters recognize that a contract is created when the accountant agrees to render services and a client agrees to pay for them. The engagement letter should be clear-cut in delineating the duties and responsibilities of the client and of the firm.
- *Other.* An engagement letter permits the orderly assessment and review by partners and staff of the services performed and the terms of the engagement. This review facilitates drafting extensions or amendments to current or succeeding years' engagements.

.07 Some firms use one engagement letter to cover several types of services; others use separate engagement letters for each service rendered. In any case, firms should consider keeping separate internal records for time incurred on the separate types of services.

## Special Considerations

.08 The following matters should be considered while preparing an engagement letter:

- a. Whether the circumstances preclude an unqualified opinion, as in these examples:
  - The auditor is retained after the beginning of the client's fiscal year, did not observe inventories or confirm receivables at the beginning of the year and was unable to satisfy self through application of alternative procedures.
  - The client imposes restrictions on the scope of the audit. (SAS No. 58, *Reports on Audited Financial Statements*, paragraph 42 [AU section 508.42]).
  - Significant litigation or other matters exist which may affect the opinion.
- b. Whether fee should be stated as a range, in hourly rates, as standard per diem charges for the engagement, or as a maximum or flat fee
- c. The person or persons to whom reports should be addressed
- d. The number of copies needed of the report and the people to whom they are to be distributed
- e. Deadlines for reports or analyses
- f. Out-of-pocket costs
- g. Additional work not contemplated in the original engagement
- h. The condition of records or circumstances other than those contemplated in the engagement letter (for example, deficient internal control)
- i. A retainer
- j. One-time engagements
- k. Start-up costs when the client changes accountants
- l. Underwriters' requirements in connection with public offerings

- m. Long-time clients who have not previously been requested to approve engagement letters
- n. The part of the work to be done by other accountants

## Contents of Engagement Letters

.09 Following are the items ordinarily covered in engagement letters:

- a. The name of the entity (and subsidiaries, if any) and its year end
- b. Statements to be audited, compiled, or reviewed
- c. The scope of services, as detailed as necessary, including limitations imposed by the client
- d. The kind of opinion, disclaimer, or other report to be rendered
- e. A disclaimer of responsibility for detecting fraud
- f. Obligations of the client's staff to prepare schedules and statements (see item 2)
- g. The requirement that the accountant read all printed material in which his report appears
- h. The responsibility for preparation or review of tax returns and subsequent tax examinations
- i. The fee, or the method of determining the fee
- j. The frequency of billing and the client's obligations for payment including a retainer, if applicable
- k. A provision for the client's acceptance signature, and the date
- l. An expression of thanks for being selected as auditors or to perform other services
- m. Before acceptance of a new engagement, an attempt that the successor auditor should make at certain communications with the predecessor auditor, as required in SAS No. 7, *Communications Between Predecessor and Successor Auditors*, paragraph 4 (AU section 315.04)

.10 The following is a list of instructions to a client's accounting staff. It includes analyses an accountant may expect the staff to prepare for the audit. Either include this list (or part of it) in the engagement letter or refer to it and then submit it as a separate memorandum.

- Balance the general ledger.
- Prepare a reconciliation for each bank account.
- Fill in and sign bank confirmation forms, to be provided by the accountant.
- Prepare a trade accounts receivable aging.
- Prepare accounts receivable confirmation letters, using drafts to be provided by the accountant.
- Prepare a schedule of accounts receivable from officers and employees.
- Prepare a schedule of bad debts written off during the year.
- Prepare a schedule of notes receivable. The notes should be available for inspection.
- Prepare a schedule of transactions with affiliated enterprises.
- Price, extend, and foot the original inventory sheets, and have them available.
- Analyze all transactions affecting marketable securities.
- Prepare an insurance schedule. The policies should be available for inspection.



- Prepare a schedule of property and equipment additions and retirements.
- Prepare a depreciation schedule.
- Prepare a schedule of life insurance for officers.
- Prepare a schedule of accounts payable. The creditor's regular monthly statements for [date] should be retained and made available.
- Prepare a schedule of notes payable.
- The corporate stock book and minutes should be up to date and available for inspection.
- Prepare a schedule of all transactions to partners' capital and drawing accounts.
- A copy of the partnership agreement or corporate charter should be available for inspection.
- Copies of all leases, including equipment rental contracts, should be available for inspection.
- Copies of employment contracts with salesmen or executives should be available for inspection.
- Copies of pension, profit-sharing, deferred compensation, and stock option agreements, and letters of acceptance from the Treasury Department, should be available for inspection.
- Prepare a schedule of repairs in excess of \$\_\_\_\_\_.
- Prepare a schedule of each officer's salary and expense account payments.
- Prepare a schedule of contributions.
- Prepare a schedule of tax expense.
- Prepare a schedule of professional fees.

.11 An engagement letter may optionally include—

- a. A description of a particular audit procedure, if requested by the client or deemed necessary for the protection of the auditor. (The detailed audit program should not be made available to client personnel, orally or otherwise.)
- b. The extent and timing of interim auditing.
- c. The name of the client's personnel to be contacted during engagement.
- d. A study and evaluation of internal control and a report thereon. (This would be a special engagement, not a part of the normal audit routine.)
- e. Interim contact and cooperation with the internal auditor.
- f. A list of services specifically excluded.
- g. Acknowledgement by the client of its responsibility for the financial statements. (Because auditors of smaller, non-public entities often may maintain accounting records, prepare financial statements, and advise management about appropriate accounting principles, such an acknowledgement may be particularly appropriate for such clients.)
- h. A statement that the client will be informed of any reportable conditions in the internal control structure that come to the auditor's attention during the audit of financial statements. (Such a communication, either orally or in writing, is required by SAS No. 60, *Communication of Internal Control Structure Related Matters Noted in an Audit* [AU section 325].)

.12 Following is a list of common engagement letter deficiencies:

- a. Reference in the letter to audit of the books and records rather than to audit of financial statements
- b. Adverse comments about other firms
- c. Failure to specify *in detail* the services to be rendered when a maximum fee is quoted
- d. Inclusion of a review of the internal control structure as one of the services when what is really intended is a consideration of the internal control structure as required by auditing standards
- e. Failure to identify accounting or other problems that may have an effect on the opinion
- f. Failure to change, in writing, the terms of the engagement when conditions are found to be different (such as the inability to express an opinion without extensive additional auditing because the internal controls were found deficient)
- g. Failure to include fee basis and payment terms
- h. Failure to identify subsidiaries
- i. Failure to identify specific tax returns to be prepared

## Client Approval

.13 It is recommended that the client's written approval of general arrangements for the engagement be secured by the accountant before proceeding with the engagement (especially in new engagements). The addressee of the letter is usually the one asked to approve the engagement. In some situations the accountant may not deem it advisable to send a client an engagement letter that requests his signature. An alternative approach might be to send the client a letter confirming the terms of the engagement, without asking him to sign it, but asking him to reply if he does not agree with the terms.

## Addressee of Letter

.14 Ordinarily, the accountant should address the letter to whomever retained the firm. If it is a corporate client's board of directors, the letter should be addressed to the board, its chairperson, or the chief executive, depending on the arrangement. If the accountant is appointed by an audit committee, it is appropriate to address the letter to the committee chairperson. If the engagement was arranged with a corporate official, the letter may be addressed to the official, personally, indicating the official's title, followed by the name of the corporation.

## Investigatory Procedures for Individuals

.15 When credit information is requested about individuals who are new clients, the investigatory procedures are subject to the Fair Credit Reporting Act of 1971.

.16 An individual should be informed in writing that an investigative consumer report, including information about the individual's character, general reputation, personal characteristics, and mode of living is being made. The individual should also be advised, within three days of the time the report is requested, that he may within a reasonable time, by written request, be furnished disclosure of the nature and scope of the investigation.<sup>2</sup>

## Filing of Engagement Letters

.17 The signed engagement letter (or original of the conforming letter) is a contract and should be filed in the client's permanent file. A copy may also be filed with the current working papers, if desired, because of the possible overlapping of billing and collecting as compared to the term of the actual engagement. This also permits easy access when reference to the previous year's letter is needed to prepare the letter for the following year's engagement.

---

<sup>2</sup> For a more complete discussion, see Carlos Martinez, "A Guide to the Fair Credit Reporting Act," *The Practical Lawyer*, December 1972.

.18 A sample checklist documenting procedures listed in this section is located in AAM section 3165.

.19 See AAM section 3175 for sample engagement letters.

---

[The next page is 3251.]

# AAM Section 3135

## *Assessment of Control Risk*

### General Comments

.01 Upon obtaining an understanding of the elements of the internal control structure as discussed in AAM section 3125, the auditor must assess control risk for financial statement assertions to determine the nature, timing and extent of tests of controls and substantive testing. The risk of material misstatement in financial statement assertions consists of inherent risk, control risk, and detection risk as discussed in AAM section 3140. Assessing control risk is the process of evaluating the effectiveness of an entity's internal control structure policies and procedures in preventing or detecting material misstatements in financial statements. Control risk should be assessed in terms of financial statement assertions.

### Consideration of the Internal Control Structure in Assessing Control Risk

.02 After obtaining the understanding of the internal control structure the auditor may assess control risk at the maximum level for some or all assertions because he believes policies and procedures are unlikely to pertain to an assertion, are unlikely to be effective, or because evaluating their effectiveness would be inefficient.

.03 Assessing control risk at below the maximum level involves:

- a. Identifying specific internal control structure policies and procedures relevant to specific assertions that are likely to prevent or detect material misstatements in those assertions.
- b. Performing tests of controls to evaluate the effectiveness of such policies and procedures.

.04 In identifying internal control structure policies and procedures relevant to specific financial statement assertions, the auditor should consider that the policies and procedures can have either a pervasive effect on many assertions or a specific effect on an individual assertion, depending on the nature of the particular internal control structure element involved. The control environment and accounting system often have a pervasive effect on a number of account balance or transaction classes and, therefore, can often affect many assertions.

.05 Conversely, some control procedures often have a specific effect on an individual assertion embodied in a particular account balance or transaction class. For example, the control procedures that an entity established to ensure that its personnel are properly counting and recording the annual physical inventory relate directly to the existence assertion for the inventory account balance.

.06 Internal control structure policies and procedures can either be directly or indirectly related to an assertion. The more indirect the relationship, the less effective that policy or procedure may be in reducing control risk for that assertion.

.07 Procedures directed toward either the effectiveness of the design or operation of an internal control structure policy or procedure are referred to as tests of controls. Tests of controls directed toward the effectiveness of the design of an internal control structure policy or procedure are concerned with whether that policy or procedure is suitably designed to prevent or detect material misstatements in specific financial statement assertions. Tests to obtain such evidential matter ordinarily include procedures such as inquiries of appropriate entity personnel, inspection of documents and reports, and observation of the application of specific internal control structure policies and procedures.

.08 Tests of controls directed toward the operating effectiveness of an internal control structure policy or procedure are concerned with how the policy or procedure was applied, the consistency with which it was applied during the audit period, and by whom it was applied. These tests ordinarily include procedures such as inquiries

of appropriate entity personnel, inspection of documents and reports indicating performance of the policy or procedure, observation of the application of the policy or procedure, and reperformance of the application of the policy or procedure by the auditor. In some circumstances, a specific procedure may address the effectiveness of both design and operation. However, a combination of procedures may be necessary to evaluate the effectiveness of the design or operation of an internal control structure policy or procedure.

.09 The conclusion reached as a result of assessing control risk is referred to as the assessed level of control risk. In determining the evidential matter necessary to support a specific assessed level of control risk at below the maximum level, the auditor should consider the characteristics of evidential matter. Generally, however, the lower the assessed level of control risk, the greater the assurance the evidential matter must provide that the internal control structure policies and procedures relevant to an assertion are designed and operating effectively.

.10 The auditor uses the assessed level of control risk (together with the assessed level of inherent risk) to determine the acceptable level of detection risk for financial statement assertions. The auditor uses the acceptable level of detection risk to determine the nature, timing, and extent of the auditing procedures to be used to detect material misstatements in the financial statement assertions. Auditing procedures designed to detect such misstatements are substantive tests.

## Documentation of the Assessed Level of Control Risk

.11 In addition to the documentation of the understanding of the internal control structure, the auditor should document the basis for his conclusions about the assessed level of control risk. Conclusions about the assessed level of control risk may differ as they relate to various account balances or classes of transactions. However, for those financial statement assertions where control risk is assessed at the maximum level, the auditor should document his conclusion that control risk is at the maximum level but need not document the basis for that conclusion. For those assertions where the assessed level of control risk is below the maximum level, the auditor should document the basis for this conclusion that the effectiveness of the design and operation of internal control structure policies and procedures supports that assessed level. The nature and extent of the auditor's documentation are influenced by the assessed level of control risk used, the nature of the entity's internal control structure and the nature of the entity's documentation of its internal control structure.

## Further Reduction in the Assessed Level of Control Risk

.12 After obtaining the understanding of the internal control structure and assessing control risk, the auditor may desire to seek a further reduction in the assessed level of control risk for certain assertions. In such cases, the auditor considers whether additional evidential matter sufficient to support a further reduction is likely to be available, and whether it would be efficient to perform tests of controls to obtain that evidential matter. The results of the procedures performed to obtain the understanding of the internal control structure, as well as pertinent information from other sources, help the auditor to evaluate those two factors.

.13 In considering efficiency, the auditor recognizes that additional evidential matter that supports a further reduction in the assessed level of control risk for an assertion would result in less audit effort for the substantive tests of that assertion. The auditor weighs the increase in audit effort associated with the additional tests of controls that is necessary to obtain such evidential matter against the resulting decrease in audit effort associated with the reduced substantive tests. When the auditor concludes it is inefficient to obtain additional evidential matter for specific assertions, the auditor uses the assessed level of control risk based on the understanding of the internal control structure in planning the substantive tests for those assertions.

.14 For those assertions for which the auditor performs additional tests of controls, the auditor determines the assessed level of control risk that the results of those tests will support. This assessed level of control risk is used in determining the appropriate detection risk to accept for those assertions and, accordingly, in determining the appropriate detection risk to accept for those assertions and, accordingly, in determining the nature, timing, and extent of substantive tests for such assertions.

.15 A sample checklist documenting procedures listed in this section is located in AAM section 3165.

---

[The next page is 3271.]

# AAM Section 3140

## *Assessing Audit Risk and Materiality*

.01 In rendering an unqualified opinion that states “In our opinion, the financial statements present fairly in all material respects . . . in conformity with generally accepted accounting principles . . .,” the auditor is giving implicit recognition to the concepts of audit risk and materiality. The existence of audit risk is implicit in the phrase “in our opinion.” Materiality is explicit in the phrase “presents fairly in all material respects in conformity with generally accepted accounting principles.”

### **Audit Risk**

.02 SAS No. 47, *Audit Risk and Materiality in Conducting an Audit* (AU section 312), defines audit risk as “the risk that the auditor may unknowingly fail to appropriately modify his opinion on financial statements that are materially misstated.” In other words, audit risk is the risk that the auditor will give an unqualified opinion on financial statements that are materially incorrect.

.03 In addition to audit risk, the auditor is also exposed to business risk in every audit engagement. Business risk is the risk that the auditor’s professional practice will suffer loss or injury from litigation or adverse publicity in connection with an audit of financial statements. Business risk is present even though the auditor conducts the audit in accordance with generally accepted auditing standards. For example, the auditor may conduct a proper audit and yet be sued by a disgruntled party without cause. Even though the auditor may win the lawsuit in such circumstances, the auditor’s professional reputation may be damaged. This type of risk differs from audit risk. Business risk cannot be used to reduce audit risk under generally accepted auditing standards.

### **Risk Components**

.04 SAS No. 47, states that audit risk consists of three components:

- a. *Inherent risk* is the susceptibility of an account balance or class of transactions to error that could be material when aggregated with error in other balances or classes, assuming that there were no related internal accounting controls. The risk of such error is greater for some balances or classes than for others. For example, complex calculations are more susceptible to theft than is an inventory of coal. Accounts consisting of amounts derived from accounting estimates pose greater risks than do accounts consisting of relatively routine, factual data. External factors also influence inherent risk. For example, technological developments might make a particular product obsolete, thereby causing inventory to be more susceptible to overstatement.
- b. *Control risk* is the risk that error that may occur in an account balance or class of transactions and that could be material, when aggregated with error in other balances or classes, will not be prevented or detected on a timely basis by the internal control structure. Control risk is a function of the effectiveness of the internal control structure. Some control risk will always exist because of the inherent limitations of any internal control structure.
- c. *Detection risk* is the risk that the auditor’s procedures will lead to the conclusion that error in an account balance or class of transactions that could be material, when aggregated with error in other balances or classes, does *not* exist, when in fact such error *does* exist. Detection risk is a function of the effectiveness of auditing procedures and of their application by the auditor. It arises partly from uncertainties that exist when the auditor does not examine 100 percent of an account balance or class of transactions and partly because of other uncertainties that exist, even if 100 percent of the balance or class has been examined. Other uncertainties arise because an auditor might select an inappropriate auditing procedure, misapply an appropriate procedure, or misinterpret audit results. These other uncertainties can be reduced to a

negligible level through adequate planning, supervision, and conduct of a firm's audit practice in accordance with appropriate quality control standards.

.05 Inherent risk and control risk differ from detection risk in that they exist independently of the audit of the financial statements. Inherent risk and control risk are functions of the client and its environment, regardless of whether an audit is conducted. Detection risk, on the other hand, relates to the auditor's procedures and can be changed at the auditor's discretion. The assessment of the potential for material misstatements occurs when the auditor considers inherent risk.

.06 The client may establish internal control structure policies and procedures to detect material misstatements and remove them from the accounting system. Ideally, the control structure should detect all material misstatements before they enter the financial statements, but sometimes the control structure may not detect a material misstatement even though it went through the control structure. For example, there may be a weakness or breakdown in the client's structure that allows a misstatement to remain undetected.

.07 Even when a client has effective internal control structure policies and procedures, certain misstatements can bypass the structure because of special circumstances. For example, if a client had an unusual exchange of nonmonetary assets, no internal control structure policies and procedures may have been established to detect a misstatement in this special circumstance.

.08 If the client's internal control structure does not detect and remove misstatements, they will flow through and be included in the financial statements. The auditor's responsibility is to design audit procedures that provide reasonable assurance that material misstatements do not remain in financial statements.

.09 The auditor will never have absolute assurance that no material misstatements exist in the financial statements. From a cost-benefit perspective, an audit providing absolute assurance that no material misstatements exist in the financial statements is impractical. Thus, the auditor designs audit tests to provide *reasonable assurance* that there are no material misstatements in the financial statements. There is always some risk that (a) material misstatements will exist; (b) they will not be detected by the client's internal control structure; (c) they will not be detected by the auditor; or (d) they will affect the financial statements. The auditor's responsibility is to reduce audit risk to an acceptably low level. Both the tests of details (tests of balances and tests of transactions) and analytical procedures are means by which the auditor detects material misstatements.

## Risk Assessment and Planning

.10 In planning the audit engagement, the auditor should assess inherent risk and control risk to determine how much detection risk can be accepted while still restricting audit risk to an acceptably low level. As the auditor's assessment of inherent risk and control risk decreases, the acceptable level of detection risk increases. The auditor should not rely on the assessments of inherent risk and control risk to the exclusion of performing substantive tests. In fact, for a small business with limited segregation of duties, the auditor often assesses inherent risk and control risk at their maximum and relies completely on substantive tests to reduce audit risk to an acceptably low level.

## Quantifying Risk

.11 The auditor's assessments of audit risk and its components of inherent risk, control risk, and detection risk are matters of *professional judgment*. Although the auditor may use quantitative tools such as decision tables and structured aids such as questionnaires to assist in assessing risk components, the ultimate assessment of audit risk is based on professional judgment.

.12 Some auditors confuse audit risk with risk associated with statistical sampling and thus erroneously assume that all audit risk can be quantified. Statistical sampling can be used to quantify the risk of misstatement in determining the extent of audit testing; that is, by using statistical sampling techniques, the auditor can quantify the risk of relying on the results of applying a procedure to a sample, rather than to 100 percent of the items in an account balance or class of transaction. However, quantitative assessment of risk using statistical sampling

techniques is only one element of audit risk. As noted previously, audit risk is composed of control risk, detection risk, and inherent risk. Detection risk, which relates to audit procedures, is a function of the nature and timing of audit procedures as well as of the extent of their application.

.13 Generally accepted auditing standards do not require the auditor to quantify risk or to perform any additional analyses of risk. Those standards simply require the auditor to plan the audit so that there is a low level of risk that an unqualified opinion will be expressed when, in fact, the financial statements are materially misstated.

## Materiality

.14 SAS No. 47 states that audit risk is “the risk that the auditor may unknowingly fail to appropriately modify his opinion on financial statements that are *materially* misstated.” As SAS No. 47 observes, audit risk and materiality should be considered together in determining the nature, timing, and extent of auditing procedures and in evaluating the results of those procedures.

.15 Materiality is the criterion used by accountants and auditors to distinguish between unimportant and important matters. Obviously, some misstatements could be included in the financial statements without precluding the auditor from expressing an opinion that the financial statements are fairly presented in all material respects in conformity with generally accepted accounting principles. The auditor’s consideration of materiality is a matter of professional judgment and is influenced by a perception of the needs of the users of the financial statements. In determining the materiality of an item, the auditor should consider the nature and amount of the item in relation to the financial statements being audited.

## In Planning

.16 In planning the audit, materiality should be viewed as an allowance for likely and potential undetected misstatements. Of course, in planning, the auditor cannot anticipate all the factors that will ultimately influence judgment about materiality in the evaluation of audit findings at the completion of the audit. Thus, materiality in planning may differ from materiality used in evaluating results at the conclusion of the audit. If the materiality amount used in evaluating audit findings is reduced significantly from the amount used in planning, the auditor should reevaluate—on the basis of planning materiality—the sufficiency of the auditing procedures that were performed. For example, an auditor may propose audit adjustments that significantly lower revenues. As a result of these adjustments, the auditor’s assessment of materiality at the conclusion of the audit may be reduced (for example, from \$1,000 to \$500). In view of the lower threshold of materiality, the auditor should evaluate whether the audit evidence obtained is sufficient.

## Quantifying Materiality

.17 Professional standards require auditors to make a preliminary judgment about materiality in the planning stage of an audit (SAS No. 47, paragraph 3 [AU section 312.03]). Although no authoritative body has established specific guidelines for materiality, some auditors believe that there are certain rules of thumb that can be used in making a preliminary assessment of materiality.

.18 Generally, auditors agree that materiality guidelines should be relative rather than absolute. In other words, materiality is usually set as a percentage rather than as an absolute amount. For example, an absolute amount such as \$100,000 may be immaterial to a large, multinational corporation but very material to a small, closely held company. To apply percentage guidelines, auditors must determine what base to use. Generally, auditors select a base that is relatively stable and predictable. Bases commonly used include net income before taxes, revenues, and total assets. Because financial statements are interrelated, and also for reasons of efficiency, auditors normally consider materiality in terms of the smallest amount that would be material to the financial statements. Generally, misstatements become material to income before they become material to the balance sheet. As a consequence, net income before taxes is often selected as the base.



.19 In small business audits, auditors sometimes make a number of significant audit adjustments. Thus, income before taxes may vary too much to be useful as a base. When net income before taxes is not used as a base, auditors sometimes use either total revenue or an average of net income for several prior periods.

### Example

.20 A common rule of thumb for materiality is 5 to 10 percent of pretax income. Some auditors apply this rule of thumb so that items less than 5 percent of normal pretax income are considered immaterial, whereas items that are more than 10 percent are material. For items between 5 and 10 percent, judgment is applied. For example, when unusual factors exist (perhaps the company is about to be sold for a multiple of audited earnings) auditors would tend to classify items between 5 and 10 percent as material. Others use 1 or 1.5 percent of the larger of total assets or revenues. (See Exhibit 1 for a sample planning materiality worksheet.)

### Exhibit 1

	<u>Initials</u>	<u>Date</u>
Done	_____	_____
Reviewed	_____	_____
Client Name Planning Materiality Worksheet Balance Sheet Date		
1. Unaudited total assets at balance sheet date		_____
2. Unaudited total revenues at balance sheet date		_____
3. Select the larger of 1 or 2		_____
4. Select a multiplier if audit risk is normal, or, if better than normal, select .1		_____
5. Multiply 3 times 4		_____
6. Unaudited pretax income (or equivalent if not a for-profit entity)		_____
7. Select a multiplier if audit risk is normal, or, if better than normal, select .1		_____
8. Multiply 6 times 7		_____
9. Evaluate 5 and 8 along with other relevant factors and determine materiality for audit planning purposes		_____

.21 Consideration of which base to use should include such factors as income variability and the nature of the client's business and industry. For a nonprofit organization, for example, the auditor would probably use total assets or revenues as a base, since pretax income is not meaningful.

.22 A sample checklist documenting procedures listed in this section is located in AAM section 3165.

[The next page is 3291.]

# AAM Section 3145

## *Errors and Irregularities*

### General Comments

.01 The auditor should assess the risk that errors and irregularities may cause the financial statements to contain a material misstatement. Based on that assessment, the auditor should design the audit to provide reasonable assurance of detecting errors and irregularities that are material to financial statements.

.02 The auditor should exercise:

- a. Due care in planning, performing, and evaluating the results of audit procedures.
- b. The proper degree of professional skepticism to achieve reasonable assurance that material errors or irregularities will be detected.

### Consideration of Audit Risk at the Financial Statement Level

.03 An assessment of the risk of material misstatements should be made during planning. The auditor's understanding of the internal control structure should either heighten or mitigate the auditor's concern about the risk of material misstatements.

.04 Factors such as those listed below may be considered:

- a. Management characteristics (e.g., management's attitude toward reporting is unduly aggressive).
- b. Operating and industry characteristics (e.g., profitability of an entity relative to its industry is inadequate or inconsistent).
- c. Engagement characteristics (e.g., significant and unusual related party transactions not in the ordinary course of business are present).

.05 The size, complexity, and ownership characteristics of the entity have a significant influence on the risk factors considered to be important.

.06 The auditor should assess risk of management misrepresentation by reviewing information obtained about risk factors and the internal control structure. Matters such as the following may be considered:

- a. Are there known circumstances that may indicate a management predisposition to distort financial statements, such as frequent disputes about aggressive application of accounting principles that increase earnings?
- b. Are there indications that management has failed to establish policies and procedures that provide reasonable assurance of reliable accounting estimates, such as personnel who develop estimates appearing to lack necessary knowledge and experience?
- c. Are there conditions that indicate lack of control of activities, such as constant crisis conditions in operating or accounting areas?
- d. Are there indications of a lack of control over computer processing, such as a lack of control over access to applications that initiate or control the movement of assets (e.g., a demand-deposit application in a bank)?

- e. Are there indications that management has not developed or communicated adequate policies and procedures for security of data or assets, such as not investigating employees in key positions before hiring?

## **The Auditor's Response to Risk at the Financial Statement Level**

.07 The auditor's overall judgment about the level of risk in an engagement may affect engagement staffing, extent of supervision, overall strategy for expected conduct and scope of audit, and degree of professional skepticism applied.

.08 Ordinarily, higher risk requires more experienced personnel or more extensive supervision by the auditor with final responsibility for the engagement during both the planning and conduct of the engagement.

.09 Higher risk may cause the auditor to expand the extent of procedures applied, apply procedures closer to or as of the balance sheet date, or modify the nature of procedures.

## **Consideration of Audit Risk at the Balance or Class Level**

.10 Examples of factors that may influence the auditor's consideration of risk of material misstatement at balance or class level are:

- a. Complexity and contentiousness of accounting issues affecting balance or class.
- b. Nature, cause, and amount of known and likely misstatements detected in the balance or class in the prior audit.
- c. Susceptibility of related assets to misappropriation.
- d. Extent of judgment involved in determining the total balance or class.

## **Professional Skepticism**

.11 An audit should be planned and performed with an attitude of professional skepticism. The auditor neither assumes that management is dishonest nor assumes unquestioned honesty.

.12 When approaching difficult-to-substantiate assertions, the auditor should recognize the increased importance of factors that bear on management integrity. A presumption of management dishonesty, however, would be contrary to the accumulated experience of auditors. Moreover, if dishonesty were presumed the auditor would potentially need to question the genuineness of all records and documents obtained from the client and would require conclusive rather than persuasive evidence to corroborate all management representations. An audit conducted on these terms would be unreasonably costly and impractical.

## **Professional Skepticism in Audit Planning**

.13 Whenever the auditor has reached a conclusion that there is significant risk of material misstatement, the auditor reacts in one or more ways.

.14 The auditor should consider this assessment in determining the nature, timing or extent of procedures, assigning staff, or requiring appropriate levels of supervision.

.15 The auditor may identify specific transactions involving senior management and confirm the details with appropriate external parties and review in detail all material accounting entries prepared or approved by senior management.

.16 The auditor should consider whether accounting policies are acceptable in circumstances. Increased risk of intentional distortion of the financial statements should cause greater concern about whether accounting principles that are otherwise generally accepted are being used in inappropriate circumstances to create a distortion of earnings.

.17 When evaluation at the financial statement level indicates significant risk, the auditor requires more or different evidence to support material transactions than would be the case in the absence of such risk. For example, the auditor may perform additional procedures to determine that sales are properly recorded, giving consideration to the possibility that the buyer has a right to return the product. Transactions that are both large and unusual, particularly at year-end, should be selected for testing.

.18 A sample checklist documenting procedures listed in this section is located in AAM section 3165.

---

[The next page is 3301.]



# AAM Section 3150

## *Illegal Acts*

### General Comments

.01 The term “illegal acts” refers to violations of laws or governmental regulations. Illegal acts by clients do not include personal misconduct by the entity’s personnel unrelated to their business activities.

.02 Whether an act is illegal is a determination that is normally beyond the auditor’s professional competence. The auditor’s training and experience may provide a basis for recognition that some client acts coming to his attention may be illegal.

### Direct and Material Effect Illegal Acts

.03 The auditor considers laws and regulations that are generally recognized by auditors to have a direct and material effect on the determination of financial statement amounts (except disclosure of contingencies). For example, tax laws affect accruals and the amount recognized as expense in the accounting period; applicable laws and regulations may affect the amount of revenue accrued under government contracts.

.04 The auditor considers such laws or regulations from the perspective of their known relation to audit objectives derived from financial statement assertions rather than from the perspective of legality *per se*.

.05 The auditor’s responsibility to detect and report misstatement resulting from illegal acts having a direct and material effect on the determination of financial statement amounts is the same as that for material errors and irregularities as described in SAS No. 53, *The Auditor’s Responsibility to Detect and Report Errors and Irregularities* (AU section 316).

### Other Illegal Acts

.06 Entities may be affected by many other laws or regulations, including those related to securities trading, occupational safety and health, food and drug administration, environmental protection, equal employment, and price-fixing or other antitrust violations. Generally, these laws and regulations relate more to an entity’s operating aspects than to its financial and accounting aspects and their financial statement effect is indirect.

.07 An auditor ordinarily does not have sufficient basis for recognizing possible violations of such laws and regulations. Their indirect effect is normally the result of the need to disclose a contingent liability because of the allegation or determination of illegality.

### Engagement Planning Procedures

.08 The auditor should assess the risks that the entity has not complied with laws and regulations which have a direct and material effect on the determination of financial statement amounts (except disclosure of contingencies) in the planning phase of the audit.

.09 Matters that may influence the auditor’s assessment include:

- a. Management’s understanding of the requirements of laws and regulations pertinent to audit objectives.
- b. The nature and extent of noncompliance noted in prior audits.
- c. Changes in requirements since the last audit.
- d. Internal control structure elements designed to give management reasonable assurance that the entity complies with those laws and regulations.
- e. The client’s policy relative to the prevention of illegal acts.

.10 Normally, there is no need to include audit procedures specifically designed to detect illegal acts.

.11 A sample checklist documenting the procedures listed in this section is located in AAM section 3165.

---

[The next page is 3331.]



# AAM Section 3155

## *Analytical Procedures*

### General Comments

.01 Understanding financial relationships is essential in planning and evaluating the results of analytical procedures and generally requires knowledge of the client and the industry or industries in which the client operates. An understanding of the purposes of analytical procedures and the limitations of those procedures is also important. Accordingly, the identification of the relationships and types of data used, as well as conclusions reached when recorded amounts are compared to expectations, requires judgment by the auditor.

.02 Analytical procedures are used for the following purposes:

- a. To assist the auditor in planning the nature, timing, and extent of other auditing procedures.
- b. As a substantive test to obtain evidential matter about particular assertions related to account balances or classes of transactions.
- c. As an overall review of the financial information in the final review stage of the audit.

Analytical procedures should be applied to some extent for the purposes referred to in (a) and (c) above for all audits of financial statements made in accordance with generally accepted auditing standards. In addition, in some cases, analytical procedures can be more effective or efficient than tests of details for achieving particular substantive testing objectives.

.03 Analytical procedures involve comparisons of recorded amounts or ratios developed from recorded amounts, to expectations developed by the auditor. The auditor develops such expectations by identifying and using plausible relationships that are reasonably expected to exist based on the auditor's understanding of the client and of the industry in which the client operates. Following are examples of sources of information for developing expectations:

- a. Financial information for comparable prior period(s) giving consideration to known changes.
- b. Anticipated results—for example, budgets or forecasts including extrapolations from interim or annual data.
- c. Relationships among elements of financial information within the period.
- d. Information regarding the industry in which the client operates—for example, gross margin information.
- e. Relationships of financial information with relevant nonfinancial information.

### Engagement Planning Procedures

.04 The purpose of applying analytical procedures in planning the audit is to assist in planning the nature, timing, and extent of auditing procedures that will be used to obtain evidential matter for specific account balances or classes of transactions. To accomplish this, the analytical procedures used in planning the audit should focus on (a) enhancing the auditor's understanding of the clients' business and the transactions and events that have occurred since the last audit date, and (b) identifying areas that may represent specific risks relevant to the audit. Thus, the objective of the procedures is to identify such things as the existence of unusual transactions and events, and amounts, ratios and trends that might indicate matters that have financial statement and audit planning ramifications.



.05 Analytical procedures used in planning the audit generally use data aggregated at a high level. Furthermore, the sophistication, extent and timing of the procedures, which are based on the auditor's judgment, may vary widely depending on the size and complexity of the client. For some entities, the procedures may consist of reviewing changes in account balances from the prior to the current year using the general ledger or the auditor's preliminary or unadjusted working trial balance. In contrast, for other entities, the procedures might involve an extensive analysis of quarterly financial statements. In both cases, the analytical procedures, combined with the auditor's knowledge of the business, serve as a basis for additional inquiries and effective planning.

.06 Although analytical procedures used in planning the audit often use only financial data, sometimes relevant non-financial information is considered as well. For example, number of employees, square footage of selling space, volume of goods produced, and similar information may contribute to accomplishing the purpose of the procedures.

.07 A sample checklist documenting procedures listed in this section is located in AAM section 3165.

---

[The next page is 3351.]

## AAM Section 3160

### *Audit Strategies and the Audit Program*

.01 The nature, timing, and extent of audit testing is discussed in AAM section 5000.

.02 A sample checklist documenting procedures listed in AAM section 5000 is located in AAM section 3165.

---

[The next page is 3361.]



# AAM Section 3165

## *Illustrative Planning Checklist*

	Done by	Date
<b>.01 A. Understanding the Assignment</b>		
1. Have engagement personnel considered the following matters in planning the engagement:		
a. The entity's accounting policies and procedures	_____	_____
b. Financial statement items likely to require adjustment	_____	_____
c. The nature of reports expected to be rendered (for example, a report on consolidated or consolidating financial statements, reports on financial statements filed with the SEC, or special reports such as those on compliance with contractual provisions)	_____	_____
2. In planning the audit, have engagement personnel—		
a. Discussed the type, scope, and timing of the audit with the entity's management, board of directors, or audit committee?	_____	_____
b. Considered the effects of applicable accounting and auditing pronouncements, particularly new ones?	_____	_____
c. Coordinated the assistance of entity personnel in data preparation?	_____	_____
d. Determined the extent of involvement, if any, of consultants, other independent auditors, specialists, and internal auditors?	_____	_____
<b>.02 B. Assigning Personnel to the Engagement</b>		
1. Has a time budget for the engagement been prepared to determine manpower requirements and to schedule fieldwork?	_____	_____
2. Has the engagement partner approved the time budget prior to the beginning of fieldwork?	_____	_____
3. Have the following factors been considered in achieving a balance of engagement manpower requirements, personnel skills, individual development, and utilization:		
a. Engagement size and complexity?	_____	_____
b. Personnel availability?	_____	_____
c. Special expertise required?	_____	_____
d. Timing of the work performed?	_____	_____
e. Continuity and periodic rotation of personnel?	_____	_____
f. Opportunities for on-the-job training?	_____	_____
4. Has the scheduling and staffing of the engagement been approved by the partner with final responsibility for the engagement, so that the partner can consider the qualifications, experience, and training of personnel to be assigned?	_____	_____
<b>.03 C. Independence</b>		
1. If acting as principal auditor, has written confirmation of the independence of other firms engaged to perform segments of the audit been obtained?	_____	_____
2. Have annual independence questionnaires been reviewed for all engagement personnel to assure that those individuals assigned to the engagement are independent?	_____	_____
3. Have accounts receivable from the client been reviewed to ascertain whether any outstanding amounts take on some of the characteristics of loans and may, therefore, impair the firm's independence?	_____	_____
4. In situations in which the firm is not independent, has the issuance of a disclaimer of opinion been discussed in accordance with Statement on Auditing Standards (SAS) No. 26, <i>Association With Financial Statements</i> , paragraphs 8—10 (AU section 504.06—.10)?	_____	_____

	Done by	Date
<b>.04 D. Knowledge of the Entity's Business</b>		
1. Has an initial, overall understanding of the clients' operations been obtained by—		
a. Reviewing the prior years' working papers, permanent file, auditors' report, and statements?	_____	_____
b. Reviewing any interim financial statements or reports for the current year, including filings with regulatory agencies; or, if such statements or reports have not been prepared, by scanning the general ledger (or trial balance) to determine whether the amounts and relationships appear reasonable in comparison with the prior years?	_____	_____
c. Reviewing most recent management letters?	_____	_____
d. Reviewing the client correspondence file?	_____	_____
e. Obtaining copies of the minutes of meetings of stockholders and the board of directors?	_____	_____
f. Considering possible impact of nonaudit services rendered to client on the audit?	_____	_____
2. Have engagement personnel obtained a knowledge of matters that relate to the nature of the entity's business, its organization, and its operating characteristics such as the following:		
a. The type of business?	_____	_____
b. Types of products and services?	_____	_____
c. Capital structure?	_____	_____
d. Related parties?	_____	_____
e. Locations?	_____	_____
f. Production?	_____	_____
g. Distribution methods?	_____	_____
h. Compensation methods?	_____	_____
3. Have engagement personnel obtained a knowledge of matters affecting the industry in which the entity operates, such as the following:		
a. Economic conditions?	_____	_____
b. Government regulations?	_____	_____
c. Changes in technology?	_____	_____
d. Accounting practices common to the industry?	_____	_____
e. Competitive conditions?	_____	_____
f. Financial trends and ratios?	_____	_____
4. Have engagement personnel consulted other sources of information that relate to the entity's business, such as the following:		
a. AICPA audit and accounting guides?	_____	_____
b. Industry publications?	_____	_____
c. Financial statements of other entities in the industry?	_____	_____
d. Textbooks, periodicals, and individuals knowledgeable about the industry?	_____	_____
5. Have methods the entity uses to process accounting information been considered in planning the audit?	_____	_____
6. Have the following matters been considered in evaluating the effect of the entity's computer processing on the audit of financial statements:		
a. The extent to which the computer is used in each significant accounting application?	_____	_____
b. The complexity of the entity's computer operations, including the use of an outside service center?	_____	_____
c. The organizational structure of the computer processing activities?	_____	_____
d. The availability of data?	_____	_____
e. The use of computer-assisted audit techniques to increase the efficiency of performing audit procedures?	_____	_____
7. Have engagement personnel considered whether specialized skills are needed to consider the effect of computer processing on the audit?	_____	_____
<b>.05 E. Assessing Auditability</b>		

	Done by	Date
1. Has the adequacy of the accounting records been assessed for the following factors:		
a. Are transactions described in sufficient detail to permit appropriate classification in financial statements?	_____	_____
b. Are transactions described in a manner that permits the recording of monetary value in the financial statements?	_____	_____
c. Do accounting records include the period in which the transactions occurred to permit the recording of transactions in the appropriate accounting period?	_____	_____
2. Has an understanding of the design of the relevant policies, procedures, and records, pertaining to the control environment, accounting system, and control procedures of the internal control structure and whether they have been placed in operation been obtained through:		
a. Previous experience with the entity?	_____	_____
b. Inquiries of appropriate management, supervisory, and staff personnel?	_____	_____
c. Inspection of entity documents and records?	_____	_____
d. Observation of entity activities and operations?	_____	_____
3. Has the understanding of the entity's internal control structure elements obtained to plan the audit been documented?	_____	_____
4. Have the following procedures been performed regarding the integrity of management:		
a. Inquiries of local attorneys, bankers, and other business leaders as to the client's standing in the business community?	_____	_____
b. A check of the client's credit rating?	_____	_____
<b>.06 F. Engagement Letter</b>		
1. Have the following items been included in the engagement letter:		
a. Name of entity (and subsidiaries, if any) and its year end?	_____	_____
b. Statement(s) to be audited, compiled, or reviewed?	_____	_____
c. Scope of services, as detailed as necessary—including limitations imposed by the client?	_____	_____
d. Type of opinion, disclaimer, or other report to be rendered?	_____	_____
e. Disclaimer of responsibility for detecting fraud (see AAM section 3175)?	_____	_____
f. Obligations of the client's staff to prepare schedule and statements?	_____	_____
g. Requirement that accountant read all printed material in which his report appears?	_____	_____
h. Responsibility for preparation or review of tax returns and subsequent tax examinations?	_____	_____
i. Fee or method of determining fee?	_____	_____
j. Frequency of billing and client's obligations for payment, including retainer, if applicable?	_____	_____
k. Provision for client's acceptance signature and date?	_____	_____
l. Expression of thanks for being selected as auditors or to perform other services?	_____	_____
m. That, in new engagements, the client should take the responsibility for getting the cooperation of the prior auditor and the successor auditor to communicate with the predecessor auditor prior to accepting the engagement?	_____	_____
2. Have the following optional items been included in the engagement letter:		
a. Description of particular audit procedure, if requested by client or deemed necessary for protection of the auditor (The detailed audit program should not be made available to client personnel, orally or otherwise)?	_____	_____
b. Extent and timing of interim auditing?	_____	_____
c. Name of client's personnel to be contacted during engagement?	_____	_____

		Done by	Date
	d. Study and evaluation of internal control and report thereon (This would be a special engagement, not part of the normal audit routine)?	_____	_____
	e. Interim contact and cooperation with internal auditor?	_____	_____
	f. List of services specifically excluded?	_____	_____
	g. Acknowledgment by the client of its responsibility for the financial statements (Because auditors of smaller, nonpublic entities often may maintain accounting records, prepare financial statements, and advise management about appropriate accounting principles, such an acknowledgment may be particularly appropriate for such clients.)?	_____	_____
	h. A statement that the client will be informed of any reportable conditions in the internal control structure that come to the auditor's attention during his audit of financial statements (Such a communication, either orally or in writing, is required by SAS No. 60, <i>Communication of Internal Control Structure Related Matters Noted in an Audit</i> [AU section 325].)?	_____	_____
.07	<b>G. Assessing Audit Risk and Materiality</b>		
	1. Have inherent and control risk been assessed to determine how much detection risk can be accepted while still restricting audit risk to an acceptably low level?	_____	_____
	2. Has a preliminary judgment about the dollar amount of misstatement that would be material to the financial statements been determined?	_____	_____
	3. Has that amount been related to tolerable error for specific account balances in planning audit procedures?	_____	_____
.08	<b>H. Assessment of Control Risk</b>		
	1. If control risk is assessed at the maximum level for some or all financial statement assertions, has that conclusion been documented?	_____	_____
	2. Have the following procedures been performed in assessing control risk at below the maximum level for some or all financial statement assertions:		
	a. Identifying specific internal control structure policies and procedures relevant to specific assertions that are likely to prevent or detect material misstatements in those assertions?	_____	_____
	b. Performing tests of controls to evaluate the effectiveness of the design and operation of such policies and procedures?	_____	_____
	3. If a further reduction in the assessed level of control risk is desired for some financial statement assertions, have additional tests of relevant controls been performed?	_____	_____
	4. Has the basis for the conclusion that control risk is assessed at below maximum level for some or all financial statement assertions been documented?	_____	_____
.09	<b>I. Errors and Irregularities</b>		
	1. Have the following factors been considered in assessing the risk of material misstatement at the financial statement level:		
	a. Management characteristics (e.g., management's attitude toward financial reporting is unduly aggressive)?	_____	_____
	b. Operating and industry characteristics (e.g., profitability of entity relative to its industry is inadequate or inconsistent)?	_____	_____
	c. Engagement characteristics (e.g., significant and unusual related party transactions not in the ordinary course of business are present)?	_____	_____
	2. Have the following factors been considered in assessing the risks of management misrepresentation at the financial statement level:		

	Done by	Date
a. Are there known circumstances that may indicate a management predisposition to distort financial statements, such as frequent disputes about aggressive application of accounting principles that increase earnings?	_____	_____
b. Are there indications that management has failed to establish policies and procedures that provide reasonable assurance of reliable accounting estimates, such as personnel who develop estimates appearing to lack necessary knowledge and experience?	_____	_____
c. Are there conditions that indicate a lack of control of activities, such as constant crisis conditions in operating or accounting areas?	_____	_____
d. Are there indications of a lack of control over computer processing, such as a lack of controls over access to applications that initiate or control the movement of assets (e.g., a demand-deposit application in a bank)?	_____	_____
e. Are there indications that management has not developed or communicated adequate policies and procedures for security of data or assets, such as not investigating employees in key positions before hiring?	_____	_____
3. Have the following factors been considered in assessing the risk of material misstatement at the balance or class level:		
a. Complexity and contentiousness of accounting issues affecting balance or class?	_____	_____
b. Nature, cause, and amount of known and likely misstatements detected in the balance or class in the prior audit?	_____	_____
c. Susceptibility of related assets to misappropriation?	_____	_____
d. Extent of judgment involved in determining the total balance or class?	_____	_____
4. Has the assessment of risk of material misstatement been considered in determining:		
a. The nature, timing or extent of audit procedures?	_____	_____
b. Assigning staff?	_____	_____
c. Requiring appropriate levels of supervision?	_____	_____
5. If it is determined that significant risk of material misstatement exists:		
a. Have the details of specific transactions involving senior management been identified and confirmed with the appropriate external parties?	_____	_____
b. Have the details of all material accounting entries prepared or approved by senior management been reviewed?	_____	_____
c. Has it been considered whether accounting policies are acceptable in the circumstances?	_____	_____
<b>.10 J. Illegal Acts</b>		
1. Have the following matters been considered in the assessment of risk that the entity has not complied with laws and regulations that have a direct and material effect on the determination of financial statement amounts:		
a. The client's policy, if any, relative to the prevention of illegal acts?	_____	_____
b. Management's understanding of the requirements of laws and regulations pertinent to audit objectives?	_____	_____
c. The nature and extent of noncompliance noted in prior audits?	_____	_____
d. Internal control structure elements designed to give management reasonable assurance that the entity complies with those laws and regulations?	_____	_____
<b>.11 K. Analytical Procedures</b>		
1. Have analytical procedures been used which focus on:		
a. Enhancing the auditor's understanding of the client's business and the transactions and events that have accrued since the last audit date?	_____	_____



		Done by	Date
	b. Identifying areas that may represent specific risks relevant to the audit?	_____	_____
.12	<b>L. Audit Strategies and the Audit Program</b>		
	1. Has the proposed audit program been developed for the engagement?	_____	_____
	2. Has the final audit program been approved by the engagement partner?	_____	_____
	_____		

[The next page is 3381.]

# AAM Section 3170

## *Audit Assignment Controls*

.01

**Audit Time Budget – Sample A**

Client \_\_\_\_\_ Audit date \_\_\_\_\_

Prepared by \_\_\_\_\_

Approved:

Supervisor \_\_\_\_\_ Date \_\_\_\_\_ Partner \_\_\_\_\_ Date \_\_\_\_\_

Preliminary work:

Start \_\_\_\_\_ End \_\_\_\_\_

Final work:

Start \_\_\_\_\_ End \_\_\_\_\_

	Budget (in hours)	
	May to Nov.	Dec. to April
Cash	_____	_____
Receivables:		
Confirmation of balances	_____	_____
Review ledgers, etc.	_____	_____
Inventories:		
Observation of physical counts	_____	_____
Price tests, etc.	_____	_____
Securities and investments	_____	_____
Property, plant, and equipment	_____	_____
Accumulated depreciation and amortization	_____	_____
Other assets	_____	_____
Notes and accounts payable	_____	_____
Tax accruals	_____	_____
Other liabilities	_____	_____
Capital stock	_____	_____
Retained earnings	_____	_____
Other equity accounts	_____	_____
Income accounts	_____	_____
Costs and expense accounts	_____	_____
Current provision for taxes	_____	_____
Other income and expense accounts	_____	_____
Minutes, agreements, etc.	_____	_____
Conferences with client	_____	_____
General supervision and planning	_____	_____
Review computer programs and auditability	_____	_____
Review of internal control	_____	_____
Review and update permanent files	_____	_____
Travel	_____	_____
Report and statement review	_____	_____
Other matters	_____	_____
Total budgeted hours	=====	=====
(Excludes tax and report departments' time)		

**-02**

[illegible]

**.03**

Year ended

.04

## Audit Time Analysis (Long Form)

	Client		Year ended					Total	Next year's budget
	Prior Years	Total	Budgeted Hours				Actual Daily Hours		
			Week beginning						
Administration									
Client conferences									
Planning and scheduling									
Staff supervision									
Accounting systems review									
Internal control									
EDP installation									
General ledger									
Cash									
Sales									
Voucher register									
Payroll									
Journal entries									
Confirmations									
Permanent file									
Client advisory comments									
Report preparation									
Financial statements									
Footnotes									
Tax return preparation									
Review									
Initial review									
Overall review									
Detailed review									
Tax accrual review									
Subtotal to next page									

Audit Time Analysis (Long Form) (Continued)

Client	Prior Years	Budgeted Hours					Actual Daily Hours					Total	Next Year's budget	
		Week beginning												
Year-end verification														
Trial balance														
Cash														
Notes receivable														
Accounts receivable														
Inventories														
Prepaid expenses														
Intercompany accounts														
Securities and investments														
Fixed assets														
Other assets														
Notes payable														
Accounts payable														
Tax grouping and accrual														
Accrued liabilities														
Deferred credits														
Contingencies and commitments														
Equity														
Audit of/with computer														
Operating accounts														
Subtotal from previous page														
Totals														
Accountants														
Manager														
In charge														
Totals														

.05

Weekly Progress Report					
Supervisor _____					Date _____
Client _____					In-charge accountant _____
					Case _____
Staff days—seven hours					
	Original Estimate	Used to date	Unused	Est. to complete	Variance
In-charge accountant	_____	_____	_____	_____	_____
Assistant (list):	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____
Total assistants	_____	_____	_____	_____	_____
Grand total	=====	=====	=====	=====	=====

\_\_\_\_\_

[The next page is 3401.]

# AAM Section 3175

## *Sample Engagement Letters*

.01 Following are illustrative engagement letters (and one engagement memorandum). They may be used as guides in the design of specific letters, tailored to satisfy the terms of a particular engagement.

### **.02 Audit Engagement Leading to Opinion**

SWIFT, MARCH & COMPANY

Certified Public Accountants

[Date]

Mr. Thomas Thorp, President  
Anonymous Company, Inc.  
Route 32  
Nowhere, New York 10000

Dear Mr. Thorp:

This will confirm our understanding of the arrangements for our audit of the financial statements of Anonymous Company, Inc., for the year ending [date].

We will audit the Company's balance sheet at [date], and the related statements of income, retained earnings, and cash flows for the year then ended, for the purpose of expressing an opinion on them. The financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audit.

We will conduct our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit will provide a reasonable basis for our opinion.

Our procedures will include tests (by statistical sampling, if feasible) of documentary evidence supporting the transactions recorded in the accounts, tests of the physical existence of inventories, and direct confirmation of receivables and certain other assets and liabilities by correspondence with selected customers, creditors, legal counsel, and banks. At the conclusion of our audit, we will request certain written representations from you about the financial statements and matters related thereto.

Our audit is subject to the inherent risk that material errors, irregularities, or illegal acts, including fraud or defalcations, if they exist, will not be detected. However, we will inform you of any such matters that come to our attention.

We will review the Company's federal and state [identify states] income tax returns for the fiscal year ended [date]. These returns, we understand, will be prepared by the controller.

Further, we will be available during the year to consult with you on the tax effects of any proposed transactions or contemplated changes in business policies.

Our fee for these services will be at our regular per diem rates, plus travel and other out-of-pocket costs. Invoices will be rendered every two weeks and are payable on presentation.

We are pleased to have this opportunity to serve you.



If this letter correctly expresses your understanding, please sign the enclosed copy where indicated and return it to us.\*

Very truly yours,

SWIFT, MARCH & COMPANY

.....  
Partner

APPROVED:

By .....

Date .....

---

\*Some accountants prefer not to obtain an acknowledgment, in which case their letter would omit the paragraph beginning "If this letter . . ." and the spaces for the acknowledgment. The first paragraph of their letter might begin as follows: "This letter sets forth our understanding of the terms and objectives of our engagement . . ."

**.03 Audit Engagement Leading to Opinion (Including Financial Information for Form 10-K)**

SWIFT, MARCH &amp; COMPANY

Certified Public Accountants

[Date]

Mr. Frederick Mead, President  
Thor Tool Co., Inc.  
473 Canyon Road  
Noplace, NJ 07000

Dear Mr. Mead:

This letter confirms our arrangements with Thor Tool Co., Inc. for the year ended [date].

We will audit the Corporation's balance sheet as of [date], and the related statements of income, retained earnings, and cash flows for the year then ended. The financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audit.

We will conduct our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit will provide a reasonable basis for our opinion.

Our procedures will include tests (by statistical sampling, if feasible) of documentary evidence supporting the transactions recorded in the accounts, tests of the physical existence of inventories, and direct confirmation of receivables and certain other assets and liabilities by correspondence with selected customers, creditors, legal counsel, and banks. At the conclusion of our audit, we will request certain written representations from you about the financial statements and matters related thereto.

Your accounting department personnel will prepare the necessary detailed trial balance and supporting schedules. We will assemble and audit the financial information required for Form 10-K and for the annual report to stockholders. Both must be submitted to us for approval before publication.

Our engagement is subject to the inherent risk that material errors, irregularities, or illegal acts, including fraud or defalcations, if they exist, will not be detected. However, we will inform you of any such matters that come to our attention.

Fees for these services will be at our standard per diem rates. Invoices, including out-of-pocket expenses, will be submitted every two weeks as the work progresses, and are payable on presentation. We estimate that our fee for this engagement will be between \$10,000 and \$12,000. Should any situation arise that would materially increase this estimate, we will, of course, advise you.

Please indicate your agreement to these arrangements by signing the attached copy of this letter and returning it to us. \*

Sincerely,

SWIFT, MARCH & COMPANY

.....  
Partner

APPROVED:

By.....

Date.....

---

\* Some accountants prefer not to obtain an acknowledgment, in which case their letter would omit the paragraph beginning "Please indicate your . . ." and the spaces for the acknowledgment. The first paragraph of their letter might begin as follows: "This letter sets forth our understanding of the terms and objectives of our engagement . . ."

**.04 Change in Circumstances From Those Contemplated in Original Engagement Letter**

SWIFT, MARCH &amp; COMPANY

Certified Public Accountants

[Date]

Mr. James Johnson, Treasurer  
Birdie Country Club  
64 Eagle Road  
Noplace, New York 10000

Dear Mr. Johnson:

As we agreed in our original engagement letter dated [date] we are notifying you that our audit of your [date] financial statements requires additional procedures.

We have found that certain guest checks are held for only three months after they are paid. Thus, a substantial number of guest checks are not available for examination. Fortunately, your system of internal control allows us to use alternative procedures to satisfy ourselves on this part of the audit. However, this will require substantially more time than examining guest checks.

The fee for these additional services will be billed at our standard per diem rates and added to the \$5,000 fee quoted in our previous letter.

The problem has been discussed with your controller, who assured us that in the future all guest checks will be kept for two years.

Please indicate your acceptance of these added terms by signing the copy of this letter and returning it to us. \*

Very truly yours,

SWIFT, MARCH &amp; COMPANY

.....  
Partner

APPROVED:

By.....

Date.....

---

\* Some accountants prefer not to obtain an acknowledgment, in which case their letter would omit the paragraph beginning "Please indicate your . . ." and the spaces for the acknowledgment. The first paragraph of their letter might begin as follows: "This letter sets forth our understanding of the terms and objectives of our engagement . . ."

**.05 Conditions Encountered Which Do Not Permit Expression of Opinion as Anticipated in Original Engagement Letter**

SWIFT, MARCH &amp; COMPANY

Certified Public Accountants

[Date]

Ms. Helene Brown, President

ZYY, Inc.

1234 West Street

Noplace, New York 10000

Dear Ms. Brown:

Our March 15, 19XX letter described our present engagement as an audit for the purpose of expressing an opinion on the company's [date] financial statements. This letter is to inform you that because of the circumstances described below, we will be required to qualify our opinion on these statements.

As you know, the Internal Revenue Service has proposed total income tax assessments of approximately \$180,000 for the three fiscal years ended [date]. Your tax counsel has advised us that although you have a defensible position and will protest the assessments, counsel cannot offer an opinion as to your ultimate liability. No provision for this assessment or any portion of it is included in your [date] financial statements, nor do you feel any is necessary. You agreed, however, that the proposed assessment and its present status will be disclosed in the notes to the financial statements.

Because of the uncertainty as to your ultimate liability, we will be unable to express an unqualified opinion. Our report will state that the financial statements are subject to the effects of such adjustments, if any, as might have been required had the outcome of this income tax matter been known.

You and your tax counsel have advised that you will inform us of any new developments in the proposed assessment before our report is issued so that we may consider their effect on your financial statements and on our report.

Very truly yours,

SWIFT, MARCH &amp; COMPANY

.....  
Partner

NOTE: The client is not asked to sign this letter. Its purpose is to inform him of the altered circumstances and the effect on the opinion. There is no change in the terms of the engagement. However, it might be desirable to have the client acknowledge receipt of this letter by signing a copy and returning it where—for example—it is a problem client, or when there has been a history of misunderstandings.

**.06 SEC Engagement: Initial Registration, Form S-1**

SWIFT, MARCH &amp; COMPANY

Certified Public Accountants

[Date]

Mr. John James, President

Odin Company, Inc.

3 Bay Drive

La Mancha, California 99999

Dear Mr. James:

This letter confirms the arrangements for our services for the registration statement Odin Company will file with the Securities and Exchange Commission.

We will audit the consolidated balance sheet of Odin Company, Inc., as at December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the three years then ended, which will be included in a Form S-1, \* registration statement. The financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on the financial statements based on our audit.

We will conduct our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit will provide a reasonable basis for our opinion. We will also audit the financial information necessary for the schedules required by Regulation S-X of the SEC.

We will perform these services as expeditiously as possible. Your accounting personnel will assist us and cooperate in the timely preparation of trial balances, schedules and account analyses, and provide clerical assistance as needed. Mr. John Brown of the law firm of Green & Brown will be liaison with counsel.

If during our engagement we find that we are unable to express an unqualified opinion on the financial statements or that we are otherwise unable to comply with the requirements of Form S-1, we will notify you of the problems encountered.

We will also fulfill the portion of the underwriter's agreement directed to the independent accountants, provided the requirements are within the purview of Statement on Auditing Standards No. 49 (*Letters for Underwriters*), issued by the American Institute of Certified Public Accountants, and provided the material can properly be reported on by accountants pursuant to that Statement. In this regard, we require that a copy of the tentative underwriting contract be given us as soon as it is available. Should that portion of the underwriting contract that deals with the details of the comfort letter be available before the balance of the underwriting contract is completely drafted, you will arrange for us to receive a copy of it.

Subsequent to issuance of our auditor's report, we will perform certain procedures required by Statement on Auditing Standards No. 37 (*Filings Under Federal Securities Statutes*), issued by the American Institute of Certified Public Accountants, regarding execution of consent letters required for certain SEC filings. In connection therewith, all printer's proofs of reports to be filed with the Securities and Exchange Commission are to be submitted to us for review. This requirement extends to the entire registration statement and all other material which accompanies the financial statements.

---

\* This should be edited to agree with the particular form to be filed.

Our engagement is subject to the inherent risk that material errors, irregularities, or illegal acts, including fraud or defalcations, if they exist, will not be detected. However, we will inform you of any such matters that come to our attention.

Our fee for services will be computed at our standard per diem rates, and will be billed to you, together with out-of-pocket costs, every two weeks. Invoices are due and payable on presentation. Before our services begin, you have agreed to pay us a \$15,000 retainer, which will be applied to the final billing for this engagement.

We appreciate your confidence in our firm by retaining us as your independent certified public accountants.

If this letter correctly expresses your understanding, please sign the enclosed copy where indicated and return it to us, together with your check for \$15,000.

Sincerely,

SWIFT, MARCH & COMPANY

.....  
Partner

APPROVED:

By.....

Date.....

**.07 Compilation of Financial Statements and Tax Services**

SWIFT, MARCH &amp; COMPANY

Certified Public Accountants

[Date]

Mr. Tom Jones, President  
ZYXWV Freight Corporation  
648 Crystal Lane  
Noplace, Anystate 00000

Dear Mr. Jones:

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

1. We will compile, from information you provide, the annual and interim balance sheets and related statements of income, retained earnings, and cash flows of ZYXWV Freight Corporation for the year 19XX. We will not audit or review such financial statements. Our report on the annual financial statements of ZYXWV Freight Corporation is presently expected to read as follows:

We have compiled the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). We have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

Our report on your interim financial statements, which statements will omit substantially all disclosures, will include an additional paragraph that will read as follows:

Management has elected to omit substantially all of the disclosures required by generally accepted accounting principles. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and changes in financial position. Accordingly, these financial statements are not designed for those who are not informed about such matters.

If, for any reason, we are unable to complete the compilation of your financial statements, we will not issue a report on such statements as a result of this engagement.

2. We will assist your bookkeeper in adjusting the books of account so that he will be able to prepare a working trial balance from which financial statements can be compiled. Your bookkeeper will provide us with a detailed trial balance and any supporting schedules we require.
3. We will also prepare the federal and state *[identify states]* income tax returns for ZYXWV Freight Corporation for the fiscal year ended December 31, 19XX.

Our engagement cannot be relied upon to disclose errors, irregularities, or illegal acts, including fraud or defalcations, that may exist. However, we will inform you of any such matters that come to our attention.

Our fees for these services . . . .



We shall be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us. \*

Sincerely yours,

.....  
Swift, March & Company

Acknowledge:

ZYXWV Freight Corporation

.....  
President

.....  
Date

---

\* Some accountants prefer not to obtain an acknowledgment, in which case their letter would omit the paragraph beginning "If the foregoing . . ." and the spaces for the acknowledgment. The first paragraph of their letter might begin as follows: "This letter sets forth our understanding of the terms and objectives of our engagement. . . ."

**.08 Review of Financial Statements and Tax Services**

SWIFT, MARCH &amp; COMPANY

Certified Public Accountants

[Date]

Mr. Tom Jones, President  
ZYXWV Freight Corporation  
648 Crystal Lane  
Nowhere, Anystate 00000

Dear Mr. Jones:

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following services:

1. We will review the balance sheet of ZYXWV Freight Corporation as of [date], and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. We will not perform an audit of such financial statements, the objective of which is the expression of an opinion regarding the financial statements taken as a whole, and, accordingly, we will not express such an opinion on them. Our report on the financial statements is presently expected to read as follows:

We have reviewed the accompanying balance sheet of ZYXWV Freight Corporation as of [date], and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management of ZYXWV Freight Corporation.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

If, for any reason, we are unable to complete our review of your financial statements, we will not issue a report on such statements as a result of this engagement.

2. We will provide your chief accountant with such consultation on accounting matters as he may require in adjusting and closing the books of account and in drafting financial statements for our review. Your chief accountant also will provide us with a detailed trial balance and any supporting schedules we require.

3. We will also prepare the federal and state [identify states] income tax returns for ZYXWV Freight Corporation for the fiscal year ended [date].

Our engagement cannot be relied upon to disclose errors, irregularities, or illegal acts, including fraud or defalcations, that may exist. However, we will inform you of any such matters that come to our attention.

Our fees for these services. . .

We shall be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.\*

Sincerely yours,

.....  
[Signature of accountant]

Acknowledge:

ZYX WV Freight Corporation

.....  
President

.....  
Date

---

\*Some accountants prefer not to obtain an acknowledgement, in which case their letter would omit the paragraph beginning "If the foregoing . . ." and the spaces for the acknowledgement. The first paragraph of their letter might begin as follows: "This letter sets forth our understanding of the terms and objectives of our engagement. . . ."

**.09 Sample Engagement Memorandum (When No Formal Engagement Letter Is Sent)****Engagement Memorandum**

[Date]

Client

ABC, Inc.

Address

711 Easy Street, La Mancha, Calif. 99999

Phone

QUincy 7-1234

Final arrangements made with

Oscar Brown, President

Date final arrangements made

February 15, 19XX at a meeting in the ABC offices

Client's personnel responsible for accounting matters

Tom Smith, Treasurer  
Joe Green, Controller

Responsibilities of client's personnel in preparation for engagement

Trial balance of G/L and completion of schedules, a list of which we will submit two weeks before beginning of engagement

Reports to be addressed to

Board of Directors (twelve copies)

Financial statements to be audited

Balance sheet at March 31, 19XX and statements of income, retained earnings, shareholders' equity and cash flows for year ended March 31, 19XX

Nature of engagement

Opinion audit and federal and state income tax returns for year ended March 31, 19XX

Date audit to commence

Approximately April 24, 19XX (check with controller about April 10)

Estimated time required

About three weeks

Staff requirements

Manager, supervisor, an in-charge senior, and two staff assistants

Billing arrangements

Every two weeks, at standard plus out-of-pocket costs; invoices to attention of Tom Smith; payable on presentation

Special accounting problems

Client was involved in a substantial sale and lease-back transaction during the year

Imputed interest may be required on long-term liabilities resulting from purchase of business

Other comments

Client is presently negotiating with machinists union

**.10 Audit of Personal Financial Statements**

[*Salutation*]

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following service(s):

1. We will audit the statement of financial condition of James and Jane Person as of [*date*], and the related statement of changes in net worth for the [*period*] then ended. Our audit will be conducted in accordance with generally accepted auditing standards and, accordingly, will include such tests of the accounting records and such other auditing procedures as we consider necessary in the circumstances. The purpose of our audit is to enable us to express an opinion regarding whether the financial statements are fairly presented in conformity with generally accepted accounting principles. Our report on the financial statements is presently expected to read as follows:

[*Standard Audit Report*]

2. We will also [*discussion of other services, if any*].

Our engagement is subject to the inherent risk that material errors, irregularities, or illegal acts, including fraud or defalcations, if they exist, will not be detected. However, we will inform you of any such matters that come to our attention.

Our fees for these services [*specify fees or terms*].

We shall be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.

Sincerely yours,

\_\_\_\_\_  
[*Signature of accountant*]

Acknowledged:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

[*Date*]

[Source: AICPA *Personal Financial Statements Guide*.]

**.11 Compilation of Personal Financial Statements**

[Salutation]

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following service(s):

1. We will compile, from information you provide, the statement of financial condition of James and Jane Person as of [date], and the related statement of changes in net worth for the [period] then ended, in accordance with standards established by the American Institute of Certified Public Accountants. We will not audit or review such financial statements. Our report on the financial statements is presently expected to read as follows:

[Standard Compilation Report]

If, for any reason, we are unable to complete our compilation of your financial statements, we will not issue a report on such statements as a result of this engagement.

2. We will also [discussion of other services, if any].

Our engagement cannot be relied upon to disclose errors, irregularities, or illegal acts, including fraud or defalcations, that might exist. However, we will inform you of any such matters that come to our attention.

Our fees for these services [specify fees or terms].

We shall be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.

Sincerely yours,

\_\_\_\_\_  
[Signature of accountant]

Acknowledged:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

[Date]

[Source: AICPA *Personal Financial Statements Guide*.]

**.12 Review of Personal Financial Statements**

[Salutation]

This letter is to confirm our understanding of the terms and objectives of our engagement and the nature and limitations of the services we will provide.

We will perform the following service(s):

1. We will review the statement of financial condition of James and Jane Person as of [date], and the related statement of changes in net worth for the [period] then ended, in accordance with standards established by the American Institute of Certified Public Accountants. We will not perform an audit of such financial statements, the objective of which is the expression of an opinion regarding the financial statements taken as a whole, and, accordingly, we will not express such an opinion on them. Our report on the financial statements is presently expected to read as follows:

[Standard Review Report]

If, for any reason, we are unable to complete our review of your financial statements, we will not issue a report on such statements as a result of this engagement.

2. We will also [discussion of other services, if any].

Our engagement cannot be relied upon to disclose errors, irregularities or illegal acts, including fraud or defalcations, that might exist. However, we will inform you of any such matters that come to our attention.

Our fees for these services [specify fees or terms].

We shall be pleased to discuss this letter with you at any time.

If the foregoing is in accordance with your understanding, please sign the copy of this letter in the space provided and return it to us.

Sincerely yours,

\_\_\_\_\_  
[Signature of accountant]

Acknowledged:

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

[Date]

[Source: AICPA *Personal Financial Statements Guide*.]

\_\_\_\_\_

# AAM Section 4000

## INTERNAL CONTROL STRUCTURE

The material included in these sections on internal control structure is presented for illustrative purposes only. The comments and illustrations are neither all inclusive nor are they prescribed minimums. They are intended as conveniences for users of this manual who may want assistance when developing materials to meet their individual needs.

This manual is a nonauthoritative kit of practice aids and, accordingly, these sections on internal control structure do not include extensive explanation or discussion of authoritative pronouncements. Users of this manual are urged to refer directly to applicable authoritative pronouncements when appropriate.

### TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
4100	Introduction .....	.01-.04
4200	General Approach .....	.01-.20
	Aids Used in Obtaining an Understanding of Internal Control Structure and Assessing Control Risk .....	.13-.15
	Special Considerations for Public Companies .....	.16
	Organization of Checklists, Questionnaires, and Other Generalized Aids .....	.17
	Formats of Checklists and Questionnaires .....	.18-.20
4250	Internal Control Structure Considerations in a Minicomputer Environment .	.010-.110
	Lack of Segregation of Functions Between the EDP Department and Users .....	.030
	Location of the Computer .....	.040
	Lack of Segregation of Functions Within the EDP Department .....	.050
	Limited Knowledge of EDP .....	.060
	Utility Programs .....	.070
	Diskettes .....	.080
	Terminals .....	.090
	Software Packages .....	.100
	Documentation .....	.110
4300	Illustrative Internal Control Structure Questions—Small Business .....	.010-.270
	I. Control Environment .....	.020
	II. Accounting System and Control Procedures .....	.030-.040
	A. General .....	.030
	B. Identified Significant Classes of Transactions .....	.040
	III. Revenue Cycle (Revenue, Receivables & Cash Receipts) .....	.050-.070
	A. Understanding—Revenues and Accounts Receivable .....	.050
	B. Control Procedures—Revenues and Accounts Receivable .....	.060
	C. Control Procedures—Cash Receipts .....	.070



<i>Section</i>		<i>Paragraph</i>
4300	<b>Illustrative Internal Control Structure Questions—Small Business— continued</b>	
	IV. Expenditures Cycle . . . . .	.080-.150
	A. Understanding—Purchasing, Receiving, and Payables . . . . .	.080
	B. Control Procedures—Purchasing . . . . .	.090
	C. Control Procedures—Receiving . . . . .	.100
	D. Control Procedures—Accounts Payable . . . . .	.110
	E. Understanding—Payrolls . . . . .	.120
	F. Control Procedures—Payrolls . . . . .	.130
	G. Understanding—Cash Disbursements . . . . .	.140
	H. Control Procedures—Cash Disbursements . . . . .	.150
	V. Production or Conversion Cycle . . . . .	.160-.220
	A. Understanding—Inventories and Cost of Sales . . . . .	.160
	B. Control Procedures—Physical Inventories . . . . .	.170
	C. Control Procedures—Perpetual Inventory Records . . . . .	.180
	D. Control Procedures—Costs . . . . .	.190
	E. Control Procedures—Receipts, Usage, and Shipments . . . . .	.200
	F. Understanding—Property, Plant, and Equipment . . . . .	.210
	G. Control Procedures—Property, Plant, and Equipment . . . . .	.220
	VI. Financing Cycle . . . . .	.230-.270
	A. Understanding—Notes Receivable and Investments . . . . .	.230
	B. Control Procedures—Notes Receivable and Investments . . . . .	.240
	C. Understanding—Notes Payable, Debt, and Other Term Obligations . . . . .	.250
	D. Control Procedures—Notes Payable, Debt, and Other Term Obligations . . . . .	.260
	E. Control Procedures—Owner's Equity . . . . .	.270
4400	<b>Illustrative Specific Internal Control Structure Objectives and Related Questions—Medium to Large Business . . . . .</b>	<b>.010-.540</b>
	I. Control Environment . . . . .	.050-.110
	A. Management Philosophy and Operating Style . . . . .	.050
	B. Organizational Structure . . . . .	.060
	C. Audit Committee . . . . .	.070
	D. Methods of Assigning Authority and Responsibility . . . . .	.080
	E. Management Control Methods . . . . .	.090
	F. Internal Audit Function . . . . .	.100
	G. Personnel Policies and Procedures . . . . .	.110
	II. Accounting System . . . . .	.120-.140
	A. General Accounting . . . . .	.120
	B. Preparation of Financial Statements . . . . .	.130
	C. Identified Significant Classes of Transactions . . . . .	.140
	III. Revenue Cycle . . . . .	.150-.200
	A. Revenue and Receivables . . . . .	.150-.180
	Sales Orders . . . . .	.150
	Credit . . . . .	.160
	Shipments . . . . .	.170
	Billings and Records . . . . .	.180
	B. Cash Receipts . . . . .	.190-.200
	Processing Collections . . . . .	.190
	Recording Collections . . . . .	.200

## Section

## Paragraph

4400	Illustrative Specific Internal Control Structure Objectives and Related Questions— Medium to Large Business—continued	
	IV. Expenditures Cycle	.210-.300
	A. Purchases and Accounts Payable	.210-.230
	Purchases	.210
	Receiving	.220
	Invoice Processing	.230
	B. Payroll	.240-.270
	Authorization of Wages, Salaries, Withholdings and Deductions	.240
	Preparation and Recording	.250
	Disbursements (Payroll)	.260
	Segregation of Functions and Physical Safeguards	.270
	C. Cash Disbursements	.280-.300
	Assignment of Functions	.280
	Processing Disbursements	.290
	Bank Reconciliations	.300
	V. Production (Conversion) Cycle	.310-.390
	A. Production Costs and Inventory	.310-.360
	Authorization of Production Activities, Planned Inventory Levels, and Service Capabilities	.310
	Recording Resources Used in Production and Completed Results	.320
	Recording Transfers to Customers and Other Inventory Dispositions	.330
	Accumulation and Classification of Production and Inventory Costs and Costs of Sales	.340
	Inventory Safeguarding	.350
	Physical Counts of Inventory	.360
	B. Property and Equipment	.370-.390
	Initiation and Execution of Property and Equipment Transactions	.370
	Recording Property and Equipment and Related Depreciation and Amortization	.380
	Safeguarding Property and Equipment	.390
	VI. Financing (Treasury) Cycle	.400-.540
	A. Investments	.400-.420
	Authorization of Investment Transactions	.400
	Recording and Classifying Investment Transactions	.410
	Physical Safeguards and Custodial Accountability	.420
	B. Borrowing (Debt and Leases)	.430-.450
	Authorization of Debt and Other Borrowing Arrangements	.430
	Recording and Classifying Debt and Other Borrowings	.440
	Safeguarding Records, Documents and Unissued Debt Instrument	.450
	C. Equity Capital	.460-.490
	Authorization of Equity Capital Transactions	.460
	Recording and Classifying Equity Capital Transactions	.470
	Physical Safeguards and Custodial Procedures	.480
	Dividend Disbursements	.490
	D. Cash	.500-.540
	Processing Collections	.500
	Recording Collections	.510
	Assignment of Disbursement Functions	.520
	Processing Disbursements	.530
	Bank Reconciliations	.540

[The next page is 4101.]

# AAM Section 4100

## Introduction

.01 The second standard of field work states, "A sufficient understanding of the internal control structure is to be obtained to plan the audit and to determine the nature, timing and extent of tests to be performed." SAS No. 55, *Consideration of the Internal Control Structure in a Financial Statement Audit* (AU section 319), indicates that the auditor should have an understanding of the control environment, the accounting system, and control procedures, i.e., the internal control structure. After the auditor obtains this understanding, he may decide to assess control risk at the maximum level. Where the assessed level of control risk is the maximum, only that conclusion need be documented. However the auditor must still document his understanding of the internal control structure.

.02 SAS No. 55 includes discussion of the subdivision of internal control structure into the control environment, the accounting system, and control procedures, and states that, "... Dividing the internal control structure into these three elements facilitates discussion of its nature and how the auditor considers it in an audit. The auditor's primary consideration, however, is whether an internal control structure policy or procedure affects financial statement assertions rather than its classification into any particular category." (SAS No. 55, paragraph 8 [AU section 319.08]). Accordingly, the term "internal control structure" is used throughout these sections.

.03 The following Statements on Auditing Standards provide authoritative interpretation of the second standard of field work:

SAS No. 55, *Consideration of the Internal Control Structure in a Financial Statement Audit* (AU section 319).

SAS No. 60, *Communication of Internal Control Structure Related Matters Noted in an Audit* (AU section 325).

.04 These sections include comments on practice aids used in obtaining an understanding of the internal control structure and assessing control risk, including illustrative examples of the following:

Internal control structure inquiries—small business.

Specific internal control structure objectives and related questions—medium to large business.

Internal control structure flowcharts—small business.

---

[The next page is 4201.]



# AAM Section 4200

## *General Approach*

.01 The auditor usually starts obtaining or updating his understanding of the client's internal control structure policies and procedures relevant to the audit of the financial statements at the beginning of field work. This timing is important because the auditor uses this current understanding in determining the nature, timing, and extent of tests of controls and substantive tests to be performed during the audit. During preliminary meetings with the client, before commencing field work, the auditor may make inquiries about the client's internal control structure policies and procedures relevant to the audit or about significant changes therein.

.02 The auditor's understanding of the internal control structure in all audits should include knowledge of each of the three elements: control environment, accounting system, and control procedures. The auditor is required to obtain a sufficient understanding of each of the three elements to plan the audit. The auditor should perform procedures to understand the design of relevant policies and procedures and whether they have been placed in operation. Generally, the policies and procedures relevant to an audit pertain to the entity's ability to record, process, summarize, and report financial data consistent with the assertions embodied in the financial statements. The auditor is not required to, but may, obtain knowledge about the operating effectiveness of relevant policies and procedures as part of the understanding of internal control structure.

.03 The control environment represents the collective effect of various factors on establishing, enhancing, or mitigating the effectiveness of specific policies and procedures. Such factors include the following:

1. Management's philosophy and operating style.
2. The entity's organizational structure.
3. The functioning of the board of directors and its committees, particularly the audit committee.
4. Methods of assigning authority and responsibility.
5. Management's control methods for monitoring and following up on performance, including internal auditing.
6. Personnel policies and practices.
7. Various external influences that affect an entity's operations and practices.

The control environment reflects the overall attitude, awareness, and actions of the board of directors, management, owners, and others concerning the importance of control and its emphasis in the entity.

.04 The accounting system consists of the methods and records established to identify, assemble, analyze, classify, record, and report an entity's transactions and to maintain accountability for the related assets and liabilities. An effective accounting system gives appropriate consideration to establishing records and methods that will:

1. Identify and record all valid transactions.
2. Describe on a timely basis the transactions in sufficient detail to permit proper classification of transactions for financial reporting.
3. Measure the value of transactions in a manner that permits recording their proper monetary value in the financial statements.

4. Determine the time period in which transactions occurred to permit recording of transactions in the proper accounting period.
5. Present properly the transactions and related disclosures in the financial statements.

.05 Control procedures are those policies and procedures in addition to the control environment and accounting system that management has established to provide reasonable assurance that specific entity objectives will be achieved. Control procedures have various objectives and are applied at various organizational and data processing levels. They may also be integrated into specific components of the control environment and the accounting system. Generally, they may be categorized as procedures that pertain to:

1. Proper authorization of transactions and activities.
2. Segregation of duties that reduce the opportunities to allow any person to be in a position to both perpetrate and conceal errors or irregularities in the normal course of his duties—assigning different people the responsibilities of authorizing transactions, recording transactions, and maintaining custody of assets.
3. Design and use of adequate documents and records to help ensure the proper recording of transactions and events, such as monitoring the use of prenumbered shipping documents.
4. Adequate safeguards over access to and use of assets and records, such as secured facilities and authorization for access to computer programs and data files.
5. Independent checks on performance and proper valuation of recorded amounts, such as clerical checks, reconciliations, comparison of assets with recorded accountability, computer-programmed controls, management review of reports that summarize the detail of account balances (for example, an aged trial balance of accounts receivable), and user review of computer generated reports.

.06 The purpose of obtaining an understanding of the internal control structure is to provide the auditor with adequate knowledge to identify the types of potential misstatements that could occur in account balances or classes of transactions and the related assertions, to consider the factors that affect the risk of material misstatement in such balances or classes, and in turn, to design appropriate tests of controls and substantive tests.

.07 Ordinarily the auditor obtains an understanding by a combination of previous experience with the entity, inquiry, inspection of documents and records, observation, and reference to prior year working papers, client prepared descriptions of the structure, or other appropriate documentation. In determining the nature and extent of procedures to obtain the understanding of each internal control structure element sufficient to plan the audit, the auditor also considers previous experience with the entity, as well as the understanding of the industry in which the entity operates, assessments of inherent risk, judgments about materiality, and the complexity and sophistication of the entity's operations. The auditor must document his understanding of the internal control structure. The extent of the auditor's documentation is directly related to the complexity of the entity's internal control structure. For example, in a large entity with a complex structure, the auditor may use questionnaires and flowcharts to obtain and document the necessary understanding. In a small, owner managed entity with a simple internal control structure, a narrative memorandum may be sufficient documentation.

.08 After documenting his understanding of the internal control structure, the auditor assesses control risk for financial statement assertions. Control risk is the risk that a material misstatement that could occur in an assertion will not be prevented or timely detected by the internal control structure. The auditor assesses control risk by evaluating the design and operating effectiveness of the policies and procedures in the control environment, accounting system, and control procedures established to prevent or timely detect misstatements, i.e., by performing tests of controls. The conclusion derived from assessing control risk is called the "assessed level of control risk." The level may vary from maximum to minimum and may be stated in either quantitative (e.g., on a "scale" or percentages) or qualitative (high, moderate, or low). The assessed level of control risk is determined by two factors:

1. The presence of (or lack of) internal control structure policies and procedures that are relevant to a financial statement assertion and
2. The extent to which the design and operation of those policies or procedures are effective in preventing or timely detecting misstatements in the assertion.

.09 At this point, the auditor may decide to assess control risk at maximum for some or all assertions because policies or procedures are not relevant to the assertions or they are unlikely to be effective. Even when potentially effective policies and procedures exist, the auditor may decide that testing their effectiveness would be inefficient, i.e. the increase in audit effort for tests of controls may outweigh the decrease in audit effort from reduced substantive testing. In such circumstances, the auditor would decide to assess control risk for these assertions at maximum level. Control risk would also be assessed at maximum when the auditor obtains evidence that policies and procedures relevant to an assertion aren't designed or operating effectively.

.10 When control risk is assessed below the maximum level, the auditor should identify internal control structure policies or procedures relevant to the assertion and perform tests of controls. Tests of controls include procedures such as inquiry, observation, and reperforming procedures by the auditor. The resulting evidence is used to assess whether control risk for the assertion is below the maximum level. The auditor considers two potential sources of evidence about the effectiveness of the design and operation of internal control structure policies and procedures:

1. The understanding of the internal control structure and
2. Any planned tests of controls performed concurrently with obtaining the understanding.

The understanding of the internal control structure may provide evidence to support an assessment of control risk at below the maximum level because certain procedures performed to obtain the understanding may provide evidence about the effectiveness of design or operation for some policies or procedures even though they weren't specifically planned to do so. This evidence may be sufficient to support an assessed level of control risk below the maximum level. It is important to note that the procedures performed in obtaining the understanding must provide sufficient evidence to evaluate the effectiveness of both the design and operation of internal control structure policies or procedures. An assessment of control risk below maximum cannot be supported unless such sufficient evidence is provided. After assessing control risk using evidence provided by the understanding of the internal control structure and planned tests of controls, the auditor may believe that a further reduction in control risk for some assertions could be supported by obtaining additional evidence. The auditor would perform additional tests of controls if doing so would increase audit efficiency.

.11 When the assessed level of control risk is below maximum, the auditor should document the basis for the assessed level of control risk. This documentation generally includes tests of controls applied to internal control structure policies or procedures. When control risk is assessed at the maximum, only the conclusion itself needs to be documented.

.12 The process of obtaining an understanding of the internal control structure and assessing the level of control risk provides the auditor with a basis for determining the nature, timing, and extent of substantive tests necessary to complete the audit. This may also be an appropriate time to communicate reportable conditions and other internal control structure related matters to the audit committee (or its equivalent).

## **Aids Used in Obtaining an Understanding of Internal Control Structure and Assessing Control Risk**

.13 The auditor may document his understanding of the internal control structure in the form of answers to a questionnaire, narrative memoranda, flowcharts, decision tables, a combination of these forms or any other form that suits the auditor's needs or preferences. Some auditors have preferences for a particular form such as flowcharts and require the form as a matter of firm policy.



.14 Auditors may find aids such as questionnaires, checklists, instructions or similar generalized materials to be useful tools in assessing control risk. These aids generally present questions or statements about internal control structure objectives and specific policies or procedures. These aids also generally include caveats that the auditor must use professional judgment in applying them in actual circumstances (including recognition of when to modify their content and when to prepare or obtain supplementary material).

.15 Some auditors design the aid to serve as a working paper when properly annotated. This type of aid is generally in checklist or questionnaire form. Others design the aid as a reference document with explicit instructions that it is intended for reference purposes and not to be annotated for use as a working paper document. Auditors who incorporate checklists or questionnaires into their working papers believe that they provide efficiency and evidence that certain predetermined matters were considered. Auditors who use reference type aids rather than aids designed to be annotated and retained in the working papers are concerned that standardized checklists may be prepared by rote. Both approaches require that the auditor use professional judgment in the circumstances. Both approaches also require that the auditor remain alert to any matters that may not be covered in the checklists or reference material.

## Special Considerations for Public Companies

.16 Auditors of public companies should be aware of the Foreign Corrupt Practices Act of 1977 which, among other things, requires public companies to "... devise and maintain a system of internal accounting controls. ...". In 1979, the SEC had proposed rules which would have required inclusion of a statement of management on internal accounting control in annual reports on Form 10-K and in annual reports to security holders and that such a statement be examined and reported on by an independent public accountant. In 1980, the SEC withdrew this proposal and decided to allow existing voluntary and private-sector initiatives for public reporting on internal accounting control (by both registrants and accountants) to continue to develop. The SEC stated its intention to monitor closely the results of such developments and revisit the issue in the spring of 1982. The AICPA Auditing Standards Board has issued SAS No. 30, *Reporting on Internal Accounting Control* (AU section 642), which describes the procedures an independent accountant should apply concerning various types of engagements to report on an entity's system of internal accounting control, and also describes the different forms of accountant's report to be issued in connection with such engagements. The AICPA Auditing Standards Board has also issued SAS No. 60, *Communication of Internal Control Structure Related Matters Noted in an Audit* (AU section 325), which provides guidance in identifying and reporting conditions that relate to an entity's internal control structure observed during an audit of financial statements.

## Organization of Checklists, Questionnaires, and Other Generalized Aids

.17 Checklist questionnaires and other generalized aids on internal control structure elements typically present numerous questions, statements, or a combination of both, about specific internal control structure, policies and procedures. Auditors differ in how they structure their materials on internal control structure. Some auditors group their material into balance sheet and related income statement classifications to ease cross-reference with sections of their working papers on substantive tests. Other auditors organize their material into broad transaction cycles. For example, purchases and accounts payable, payrolls, accrued expenses, and cash disbursements may be grouped as an expenditures cycle. This approach transcends the differences in how companies are organized and helps to get an overview of all the effects of transactions across various functional lines within a company. Other auditors organize their material by functions within a company. Examples are requisitioning, purchasing, receiving, invoice processing, accounts payable recording, and payment functions which may be grouped as purchases and payables. This approach follows the established organizational lines in a company and aids in determining who is responsible for performance of prescribed internal control structure procedures. These approaches are conceptual notions and may be applied to large or small organizations. The decision to organize internal control structure material on the statement classification approach, cycle approach, business function approach, or any other suitable approach rests with the individual auditor or firm. Following are some further illustrations of these grouping approaches:

- Related Balance Sheet and Income Statement Classifications: (1) general; (2) cash receipts, disbursements, and balances; (3) accounts receivable and sales; (4) inventory and cost of sales; (5) property, plant and equipment, and related depreciation; (6) investments; (7) accounts payable and purchases; (8) payroll; (9) debt; and (10) equity capital.
- Transaction Cycles: (1) revenue (customer acceptance, credit, shipping, sales, cash receipts, receivables, allowances for doubtful accounts, sales warranties, etc.); (2) expenditures (purchases, payrolls, cash disbursements, accounts payable, accrued expenses, etc.); (3) production or conversion (inventory, cost of sales, property and related depreciation, etc.); (4) financing (investments, debt, leases, equity capital); and (5) financial reporting.<sup>1</sup>
- Groupings of Business Functions: (1) financial reporting (controllanship, general accounting); (2) EDP; (3) financial management (cash receipts and disbursements, cash balances and investments, debt, leases, and equity capital); (4) sales and credit (order entry, credit, shipping, billing, receivables and collections); (5) inventory and production costs (production planning and operations, cost accounting, inventory recordkeeping, and inventory custody); (6) productive assets (planning and authorization for capital assets, accounting for property and related depreciation, maintenance, and asset custody); (7) purchases and payables (purchasing, receiving, invoice processing, and disbursements); and (8) employee compensation and benefits (personnel, employee supervision, payroll preparation and recording, and disbursements).

## Formats of Checklists and Questionnaires

.18 Checklist questions are usually worded so a “yes” answer indicates that the client uses a particular policy or procedure. “No” answers serve as signals that the client’s internal control structure may have a potential reportable condition unless the client has other policies or procedures that accomplish the same objectives as would the absent procedure. “No” answers pose an especially important documentation problem because they require consideration of the following:

- Should the absent procedure be dismissed as not applicable because it is not relevant in the client’s circumstances?
- Does the client have other policies or procedures that accomplish the objective of the absent procedure so that the answer does not indicate a potential reportable condition?
- Does the deficiency require modification of the audit program for substantive tests or are the tests adequate despite the deficiency?
- Is the deficiency a reportable condition requiring communication in accordance with SAS No. 60 (AU section 325)?
- How should other deficiencies be communicated to the client?

Because of these considerations, the formats of questionnaires usually call for information in addition to simply checking yes and no answers. Some questionnaires provide an additional column for “not applicable” and a wide column for additional comment on conclusions about other compensating policies and procedures and the needs for program modifications and/or written communication to the client.

.19 Some questionnaire formats provide additional columns for information such as the following:

- Name of client’s employee or group of employees who perform the procedure.
- Specific cross-reference to flowcharts and/or narratives included in the auditor’s working papers.

---

<sup>1</sup> The financial reporting cycle would include general accounting and preparation of such reports as financial statements, tax returns, and reports to regulatory bodies. For nonpublic companies which work closely with their auditors in preparing such reports, review of internal control structure for the financial reporting cycle may be a moot point.

- Specific cross-reference to working papers on tests of controls.
- Specific cross-reference to compensating policies and procedures for absent items; compensating policies and procedures may be represented by other checklist items or noted in complementary memoranda or procedures not anticipated in the questionnaire.
- Specific cross-reference to memoranda on internal control structure deficiencies and their effect on the audit program and development of management letter comments.

.20 Some questionnaires provide for the auditor to initial and date each item. Others provide entry of the date and auditor's signature after each group of questions for a particular transaction cycle or functional grouping. Some questionnaires also include blank formats with preprinted captions on which the auditor may prepare annotations about specific internal control structure deficiencies, conclusions about findings, and proposed amendments (if any) to the audit program. These preprinted captions for example, may include the following:

- Explanation of a specific deficiency or new strength (generally cross-referenced to a specific item in the body of the checklist).
  - Cross-reference to a specific compensating internal control structure policy or procedure, if any.
  - Whether amendment of the audit program is needed concerning:
    - (a) Further restriction of audit procedures.
    - (b) Extension of audit procedures.
    - (c) Modification of the extent or timing of audit procedures.
- 

[The next page is 4227.]

## AAM Section 4250

# *Internal Control Structure Considerations in a Minicomputer Environment*

**.010** The use of minicomputers to process accounting applications has become increasingly common in entities of all sizes. In a minicomputer environment, as elsewhere, the auditor studies the internal control structure, which includes both the EDP and non-EDP features of the minicomputer system. In 1981, AICPA published "Audit and Control Considerations in a Minicomputer or Small Business Computer Environment" as part of its Computer Services Guidelines. That document discusses, among other things, audit and planning considerations, substantive audit techniques, and computer-assisted audit techniques in a minicomputer environment. It may be helpful to auditors who wish to acquire more knowledge about the effect of the use of a minicomputer on the audit plan.

**.020** "Audit and Control Considerations in a Minicomputer or Small Business Computer Environment" includes a table that lists the risks and relevant control policies and procedures associated with characteristics frequently found in a minicomputer environment. That table is reproduced below as an aid to auditors assessing control risk in a minicomputer environment.

### **.030 Lack of Segregation of Functions Between the EDP Department and Users**

(Personnel in the user department initiate and authorize source documents, enter data into the system, operate the computer, and use the output reports.)

#### ***Risks***

Perpetration and concealment of errors or irregularities.

Unauthorized changes to master files.

Inaccurate and incomplete processing of data.

Processing errors.

Incomplete or erroneous data.

Uncorrected errors.

Lost, added, or altered data.

#### ***Relevant Control Policies and Procedures***

Maintenance of transaction logs and batch controls by user department.

Independent review of processing logs, transaction logs, and batch control information.

Management supervision.

Passwords to control access to files and libraries.

Required vacations and rotation of duties.

Reconciliation of record counts or hash totals.

Use of application programs to make changes in master files.

Independent reconciliation of transaction totals recorded in batch control logs with input and output totals.

Comparison of system manufacturer's utility program with authorized application version.

**.040 Location of the Computer**

(The computer is located in the same area as the user department.)

***Risks***

Improper use or manipulation of data files.

Unauthorized use or modification of computer programs.

Improper use of computer resources.

***Relevant Control Policies and Procedures***

Menus and procedures to control processing access.

Management review of usage reports (history logs).

Periodic comparison of usage reports with processing schedule.

Physical control over data entry devices.

**.050 Lack of Segregation of Functions Within the EDP Department**

(There is no segregation between programmers and operators.)

***Risks***

Unauthorized access to information and programs.

Perpetration and concealment of errors or irregularities.

Errors caused by improper use or manipulation of data files or unauthorized or incorrect use of computer program.

Application programs that do not meet management's objectives.

***Relevant Control Policies and Procedures***

Use of a compiler to convert the source code into object code.

Comparison of library directories with manual records.

Comparison of program in use with an authorized version.

Use of interpretive language programs.

Passwords to control access to libraries and files.

Software controls to limit system access capabilities according to employee function.

Test libraries.

Management review of usage reports (history logs).

Systems of transaction logs, batch controls, processing logs and run-to-run controls.

**.060 Limited Knowledge of EDP**

(Supervisor responsible for data processing has limited knowledge of EDP.)

**Risks**

Failure of systems to meet management objectives or operate according to management specifications.

Lack of adequate application controls.

Inadequate testing and review of systems.

**Relevant Control Policies and Procedures**

Operations documentation.

Program documentation.

Systems documentation.

Use of third party to review new and modified programs and systems.

**.070 Utility Programs**

(Utility programs are used extensively to enter and to change data.)

**Risks**

Unauthorized access and changes to data.

Undetected errors in file manipulation.

Lack of adequate application controls.

Processing of unauthorized transactions and omitting of authorized transactions.

Perpetration and concealment of errors or irregularities.

**Relevant Control Policies and Procedures**

Use of passwords to control access to data files.

Use of application programs to update files.

Independent control over transaction and master file changes, such as item count, control total, and hash totals.

Limited access to utilities.

Removal of utilities from system when practical to do so.

**.080 Diskettes**

(Diskettes are used extensively for file storage.)

**Risks**

Processing of the wrong file.

Inability to detect errors in file changes.

Inability to highlight operator errors.

**Relevant Control Policies and Procedures**

Control over access to diskettes.

Storage of data in format not readable by key entry devices.

Use of manual logs to control diskette library.

#### **.090 Terminals**

(Terminals are used for transaction data entry, inquiry, and other interactive functions.)

##### ***Risks***

Unauthorized input.

Erroneous or fraudulent data.

Errors caused by improper use or manipulation of data files or computer programs.

Erroneous or incomplete data.

##### ***Relevant Control Policies and Procedures***

Use of software that will allow only certain terminals to be used for specific functions.

Use of physical controls to limit access to data files.

Use of passwords to control access to data files.

Encryption of data and programs.

On-line computer edit procedures.

Record counts, batch controls, run-to-run controls, verification.

Error handling control procedure and error logs.

Use of menus and procedures.

#### **.100 Software Packages**

(Purchased software packages are used extensively rather than internally developed application software.)

##### ***Risks***

Failure of systems to meet management and user objectives.

Lack of adequate applicator controls.

Inadequate testing of systems.

##### ***Relevant Control Policies and Procedures***

Use of third party to review and evaluate proposed software packages.

#### **.110 Documentation**

(Available system program, operator, and user documentation may be limited or nonexistent.)

##### ***Risks***

Undetected errors during processing and system maintenance.

##### ***Relevant Control Policies and Procedures***

User-based controls.

---

[The next page is 4301.]

# AAM Section 4300

## *Illustrative Internal Control Structure Questions—Small Business*

.010 The following is a list of illustrative internal control structure questions an auditor might raise concerning a small manufacturing operation owned by one person who also serves as the general manager and has only a few employees involved in the accounting function. These illustrative questions assume that accounting services will be performed by the CPA in compiling financial statements. These illustrative questions are numbered merely for organization purposes; the numbers are in no way intended to infer completeness or a preferred sequence. This list will require modification for other types of entities. Because this list is merely illustrative, some auditors may find it not extensive enough, while others may find it too detailed. Others may prefer a different organization or sequence for the inquiries. A firm that believes the questionnaire approach is appropriate for its practice should develop its own internal control structure questionnaires based on its own needs and preferences. In any event, users of checklists and questionnaires should recognize that important matters in a particular set of circumstances may not be covered in a standard checklist.

.020

### **I. Control Environment**

1. Does the owner reasonably understand the form and content of the financial statements and such required reports as tax returns?
2. Does the owner use operating budgets and cash projections? If so,
  - a. Do the budgets and projections lend themselves to effective comparison with actual results?
  - b. Are material variances reviewed and explained?
3. Are monthly comparative financial reports prepared which are sufficiently informative to highlight abnormalities?
4. Is there adequate control including a reporting schedule and assigned responsibility for preparation of required financial statements and government regulatory reports?
5. Are the personal funds of the owner including his personal income and expenses completely segregated from the business?
6. Is the bookkeeper required to take annual vacations and does someone else perform the bookkeeping duties during that time?
7. Are there adequate safekeeping facilities for custody of the accounting records such as fireproof storage areas and restricted access cabinets?
8. Is there adequate fidelity bond coverage of employees who handle cash, securities, other valuable assets and accounting records?
9. Is the adequacy of insurance coverage periodically reviewed?
10. Is there a suitable records retention plan?
11. Is the owner satisfied that all employees are competent and honest?



**II. Accounting System and Control Procedures\*****.030 A. General**

1. Is a complete and current chart of accounts used?
2. Is a double entry bookkeeping system in use which includes a general ledger, source journals, and suitable subsidiary records?
3. Do the records provide for efficient accumulation of entries and avoidance of unnecessary duplicate work?
4. Are standard journal entries used to the extent practicable?
5. Are journal entries understood and authorized by the owner?
6. Are the source journals posted promptly and the general ledger and subsidiary ledgers kept current and balanced monthly?

**.040 B. Identified Significant Classes of Transactions**

1. Revenue Cycle (Revenue, Receivables, and Cash Receipts)?
2. Expenditures Cycle (Purchases, Payables, Payrolls, Cash Disbursements)?
3. Production or Conversion Cycle (Inventories, Cost of Sales, Property, Plant, and Equipment)?
4. Financing Cycle (Notes Receivable, Investments, Notes Payable, Debt, Other Long-Term Obligations, and Owner's Equity)?

**III. Revenue Cycle (Revenue, Receivables & Cash Receipts)****.050 A. Understanding—Revenues and Accounts Receivable**

1. How are sales transactions initiated?
2. What document or record is used to evidence initiation?
3. What are the responsibilities of personnel involved with initiating sales?
4. How are sales transactions recorded?
5. How often are sales journal entries prepared?
6. How are collections received?
7. What document or record is used to evidence collections?
8. What are the responsibilities of personnel involved with collections?
9. How often are bank deposits made?
10. How are credits to customers' accounts initiated?
11. What documents are used to evidence credits?
12. What are the responsibilities of personnel involved with initiating credits?

**.060 B. Control Procedures—Revenues and Accounts Receivable**

1. Is credit approved by the owner or a designated credit manager?

---

\* The accounting system and control procedure elements are combined because they are highly interrelated and often inseparable. Generally, the auditor has a greater responsibility to understand the accounting system than to understand specific control procedures.

2. Are credit files maintained on a current basis for significant customers?
3. Are commission rates set or approved by the owner?
4. Are sales orders or work orders approved by the owner or a responsible employee for:
  - a. Price?
  - b. Terms of sale, including delivery dates?
  - c. Credit?
  - d. Account balance limits?
5. Are all sales orders (or work orders) recorded on pre-numbered forms and are all numbers accounted for?
6. Are shipping documents:
  - a. Prepared for all shipments?
  - b. Pre-numbered and all numbers accounted for?
  - c. Based on approved sales orders and matched with sales invoices?
  - d. Processed promptly?
7. Are all sales invoices:
  - a. Pre-numbered and all numbers accounted for?
  - b. Compared to shipping documents?
  - c. Checked for price and terms?
  - d. Checked for clerical accuracy?
  - e. Recorded promptly?
8. Are all credit memos pre-numbered and all:
  - a. Numbers accounted for?
  - b. Approved?
  - c. Recorded promptly?
9. Is there a proper cut-off of sales at month end?
10. Are monthly statements of account for all trade receivable balances:
  - a. Reviewed by the owner before mailing?
  - b. Mailed by the owner or a responsible employee other than the bookkeeper?
11. Is the accounts receivable subsidiary ledger balanced monthly to the general ledger control account?
12. Is an aging schedule or schedule of past due customers' accounts prepared monthly?
13. Does the owner or credit manager review monthly listings of past due customer accounts and investigate delinquent accounts and unusual items?
14. Are write-offs and other adjustments to customers' accounts authorized by the owner?

**.070 C. Control Procedures—Cash Receipts**

1. Does the owner or a responsible employee other than the bookkeeper or person who maintains accounts receivable detail:
  - a. Open the mail and prelist all cash receipts before turning them over to the bookkeeper?
  - b. Stamp all checks with the restrictive endorsement “for deposit only” before turning them over to the bookkeeper?
  - c. Subsequently compare the daily prelisting of cash receipts with:
    - (i) The cash receipts journal?
    - (ii) The duplicate deposit slip?
2. Are cash receipts deposited intact on a daily basis?
3. Are cash receipts posted promptly to the accounts receivable subsidiary records?
4. Are discounts taken checked for conformity with an authorized policy?
5. Are cash sales controlled by cash registers or pre-numbered cash receipt forms?
6. If cash registers are used, does a responsible employee other than the cash register operator (cashier)—
  - a. Have custody at all times of the key to the cash register tape compartment?
  - b. Take periodic readings of the register and compare such with the cashier’s record of cash receipts?

**IV. Expenditures Cycle****.080 A. Understanding—Purchasing, Receiving, and Payables**

1. How are purchase transactions initiated?
2. What document or record is used to evidence the initiation of purchases?
3. What are the responsibilities of personnel involved with initiating purchases?
4. How are purchase transactions recorded?
5. What document or record is used to evidence the receipt of purchased goods?

**.090 B. Control Procedures—Purchasing**

1. Does the owner or a designated person other than the bookkeeper do the purchasing?
2. Are all purchases over a predetermined dollar amount approved by the owner?
3. Are purchases of services, property and equipment, investments and other non-routine items approved by the owner?
4. Are all purchases based on purchase orders which present descriptions, quantities, and prices which are approved before issuance?
5. Are all purchase order forms pre-numbered and is custody of unissued forms adequate to prevent their misuse?
6. Are issued purchase orders listed in detail showing order numbers, vendors’ names, quantities, and prices to control their issuance and disposition? (This may be in the form of a register, log, or file of copies of issued purchase order forms.)

7. Are open purchase orders periodically reviewed for delivery period so that past due orders may be brought to the owner's attention?

**.100 C. Control Procedures—Receiving**

1. Are all materials inspected for condition and independently counted, measured or weighed when received?
2. Are receiving reports used and prepared promptly? (Note: copies of purchase orders with the quantities blanked out may serve this purpose.)
3. Are receiving reports subjected to the following:
  - a. Pre-numbering and accounting for the sequence of all numbers? (This may be coordinated with accounting for all purchase orders—see items 5 and 6 in AAM section 4300.090.)
  - b. Promptly provided (by copies) to those who perform the purchasing and accounting (accounts payable) functions?
  - c. Controlled so that the liability may be determined for materials received but not yet invoiced?

**.110 D. Control Procedures—Accounts Payable**

1. Are vendor's invoices:
  - a. Matched with applicable purchase orders?
  - b. Matched with applicable receiving reports?
  - c. Reviewed for correctness of:
    - (i) Quantities received?
    - (ii) Prices charged?
    - (iii) Clerical accuracy (extensions & footings)?
    - (iv) Account distribution?
2. Are all available discounts taken?
3. Is there written evidence that invoices have been properly processed (for example, a block stamp, attachment of a voucher form, annotations) before payment?
4. Are duplicate invoices conspicuously stamped or destroyed as a precaution against duplicate payment?
5. Are approved debit memos used to notify vendors of goods returned to them and other adjustments of their accounts?
6. Are there procedures which provide that direct shipments to customers, if any, are properly billed to them?
7. Does the owner verify that the trial balance of accounts payable agrees with the general ledger control account?
8. Does the owner verify that other key accounts agree with the subsidiary records?
9. Are vendors' statements reconciled with accounts payable detail?
10. Are vendors' statements checked by the owner periodically for overdue items?
11. Are expense accounts:

- a. Submitted promptly?
- b. Adequately supported?
- c. Approved before payment?

**.120 E. Understanding—Payrolls**

1. How is time worked by employees accounted for?
2. What document or record is used to evidence hours worked?
3. What are the responsibilities of personnel involved in the computation of payroll?
4. How are payroll transactions recorded?

**.130 F. Control Procedures—Payrolls**

1. Are all employees hired by the owner?
2. Are individual personnel files maintained?
3. Is access to the personnel files limited to the owner or a designee who is independent of the payroll or cash functions?
4. Are wages, salaries, commission, and piece rates approved by the owner?
5. Are proper authorizations obtained for all payroll deductions?
6. Is gross pay determined using authorized rates and:
  - a. Adequate time records for employees paid by the hour?
  - b. Piece work records for employees whose wages are based on production?
  - c. Are piece rate records reconciled with production records or are counts spot checked?
  - d. Salesmen's commission records reconciled with sales records?
7. If employees punch time clocks, are the clocks located so they may be watched by someone with authority?
8. Are time records for hourly employees approved by a foreman or supervisor?
9. Would the owner be aware of the absence of any employee?
10. Is the clerical accuracy of the payroll checked?
11. Are payroll registers reviewed by the owner?
12. Is an imprest bank account used for payroll, and does the owner compare deposits to the account with the payroll register?
13. Does the owner approve, sign, and distribute payroll checks?
14. If employees are paid in cash, does the owner compare the cash requisition to the net payroll?
15. Does the owner maintain control over unclaimed payroll checks?

**.140 G. Understanding—Cash Disbursements**

1. How are cash disbursements initiated?
2. What document or record is used to evidence cash disbursements?

3. What are the responsibilities of personnel involved in disbursing cash?
4. How are cash disbursements recorded?

**.150 H. Control Procedures—Cash Disbursements**

1. Are all disbursements except from petty cash made by check?
2. Are checks pre-numbered and all numbers accounted for?
3. Are all checks recorded when issued?
4. Are all unused checks safeguarded (i. e., is access limited to the owner)?
5. Is a mechanical check protector used to inscribe amounts as a precaution against alteration?
6. Are all voided checks retained and mutilated?
7. Are all checks signed by the owner?
8. If a signature plate is used, is it under sole control of the owner?
9. Are supporting documents (processed invoices, receiving reports, purchase orders, etc.) presented with the checks and reviewed by the owner before he signs the checks?
10. Are supporting documents for checks properly cancelled to avoid duplicate payment?
11. Are checks payable to cash prohibited?
12. Are signed checks mailed by someone independent of the accounts payable function?
13. Are bank statements and paid checks:
  - a. Received directly by the owner?
  - b. Reviewed by the owner before they are given to the bookkeeper?
14. Are bank reconciliations prepared:
  - a. Monthly for all accounts?
  - b. By someone other than the cashier or persons authorized to sign checks or use a signature plate if they are other than the owner?
15. Are bank reconciliations reviewed and adjustments of the cash accounts approved by the owner?
16. Are all disbursements from petty cash funds supported by approved vouchers which are prepared in ink and cancelled to prevent reuse?
17. Is there a predetermined maximum dollar limit on the amounts of individual petty cash disbursements?
18. Are petty cash funds on an imprest basis and:
  - a. Kept in a safe place?
  - b. Reasonable in amount so that the fund ordinarily requires reimbursement at least monthly?
  - c. Controlled by one person?
  - d. Periodically counted by someone other than the custodian?

**V. Production or Conversion Cycle****.160 A. Understanding—Inventories and Cost of Sales**

1. What types of documents or records are kept to control inventory items?
2. What are the responsibilities of personnel involved with inventory record keeping?

**.170 B. Control Procedures—Physical Inventories**

1. Are physical counts made of all classes of inventory at least once a year?
2. Are physical inventory procedures supervised by the owner or a responsible employee?
3. Do written inventory procedures exist and, if so, are they determined or approved by the owner?
4. Do the inventory procedures adequately address the following matters:
  - a. Location and orderly physical arrangement of inventories?
  - b. Identification and description of the inventories by persons familiar with it?
  - c. Segregation and proper identification of goods that are not property of the client, such as customers' goods and goods held on consignment?
  - d. Method of determining quantities such as weight, count or measure?
  - e. Identification of stock counted to determine all items are counted and to preclude duplicate counting?
  - f. Cutoff of receipts and deliveries?
  - g. Control of physical inventory records, such as pre-numbering of all count sheets, count tickets, and accounting for all numbered records issued and used?
  - h. Identification of slow moving, obsolete, and damaged items?
5. Are inventories under physical control of a designated storekeeper who is responsible for quantities and who is also not the bookkeeper?
6. Are there reasonable safeguards against theft or pilferage such as fences or locked areas?
7. Are the inventories adequately insured?

**.180 C. Control Procedures—Perpetual Inventory Records**

1. Are perpetual inventory records maintained and, if so,—
  - a. Are the perpetual records controlled by general ledger accounts and adjusted to periodic physical inventories at least once a year?
  - b. Are the perpetual records kept by someone other than the person(s) who has custody of the physical stock?
  - c. Are differences between physical counts and perpetual records investigated?
  - d. Are adjustments to the perpetual records approved by the owner?

**.190 D. Control Procedures—Costs**

1. Do the accounting records provide for properly classified accumulation of the costs of raw materials, direct labor, and overhead (including indirect labor)?

2. Do the accounting records accumulate quantities or units of finished products sold and units of raw materials used in production in sufficient detail and with proper cut-off to provide for adequate determination of cost of goods sold and cost of inventories?
3. Does the client's production process lend itself to accumulation of costs by job order or units processed, and if so, is an appropriate cost accounting system used?
4. Is the cost accounting system tied in with or reconciled to the general ledger?
5. Are production cost budgets and production reports prepared periodically?
  - a. Do the budgets lend themselves to comparison with actual costs?
  - b. Are differences between budget and actual costs investigated and explained?
  - c. Are production cost budgets and comparisons with actual costs reviewed by the owner?

**.200 E. Control Procedures—Receipts, Usage, and Shipments**

1. Do receiving personnel verify the quantity and quality of materials purchased and prepare formal receiving reports?
2. Are signed requisitions required for release of all materials from the storeroom and, if so, are the requisitions pre-numbered and all numbers accounted for?
3. Are all shipments of finished goods based on approved shipping advices?
4. Are shipping and receiving areas separate from inventory storage areas?

**.210 F. Understanding—Property, Plant, and Equipment**

1. What types of documents or records are kept to control fixed assets?
2. What are the responsibilities of personnel involved with fixed asset record keeping?

**.220 G. Control Procedures—Property, Plant, and Equipment**

1. Are all additions authorized by the owner?
2. Does the owner understand and approve the estimated lives and methods of depreciation for depreciable property?
3. Does the owner authorize all retirements?
4. Are there detailed records of property, plant, and equipment which—
  - a. Identify specific assets including their costs and acquisition dates?
  - b. Show related depreciation?
  - c. Are balanced periodically (at least annually) with the general ledger control accounts?
5. Are there adequate detailed records for leased property under capital leases?
6. Are periodic physical inventories or inspections made of property, plant, and equipment?
7. Are depreciable lives periodically reviewed for adequacy in relation to unanticipated use or obsolescence based on actual experience?

**VI. Financing Cycle**

**.230 A. Understanding—Notes Receivable and Investments**



1. What types of records or documents are kept for notes receivable and investments?
2. What are the responsibilities of personnel involved with keeping records for notes receivable and investments?

**.240 B. Control Procedures—Notes Receivable and Investments**

1. Does the owner authorize all notes receivable?
2. Are all investment purchases and sales authorized by the owner?
3. Is a detailed record of notes and investments maintained including related income?
  - a. Is the record kept current?
  - b. Is the record reconciled to the general ledger control accounts?
4. Are investments registered in the name of the company?
5. Does owner have sole access to notes and investment certificates?
6. Are investments kept in a safe place?
7. Are investments counted or confirmed periodically?

**.250 C. Understanding—Notes Payable, Debt, and Other Term Obligations**

1. What types of records or documents are kept for notes payable, debt, and other term obligations?
2. What are the responsibilities of personnel involved with keeping records for notes payable, debt, and other term obligations?

**.260 D. Control Procedures—Notes Payable, Debt, and Other Term Obligations**

1. Does the owner negotiate all borrowings?
2. Does the owner understand the terms, conditions and finance cost (interest) of all debt and lease obligations of a financing nature?
3. Are detailed, up-to-date records maintained of notes payable, long-term debt, and other term obligations such as leases?
4. Are the company files adequate regarding copies of outstanding notes, bonds, mortgages, and leases?
5. Are paid bonds and notes effectively cancelled and retained in the company?

**.270 E. Control Procedures—Owner's Equity**

1. If doing business as a corporation:
  - a. Are the owner's records safeguarded and in order regarding the certificate or articles of incorporation, bylaws, unissued stock certificates (if any), and relevant correspondence with legal counsel?
  - b. Does the general ledger include appropriate capital accounts?
  - c. Are minute books maintained and properly safeguarded?
2. If doing business as a sole proprietorship, does the general ledger include appropriate capital accounts?

---

[The next page is 4401.]

## AAM Section 4400

### *Illustrative Specific Internal Control Structure Objectives and Related Questions—Medium to Large Business*

.010 This section lists specific internal control structure objectives and related questions that an auditor might raise concerning a medium to large business with enough employees to be able to achieve a reasonable segregation of duties. These illustrative objectives and related questions are organized into control environment, accounting system, and four broad transaction classes which are further divided into various subheadings. This is to provide some additional illustration of the concepts discussed in AAM section 4200.17 on organization of checklist questionnaires and other generalized aids.

.020 As discussed in AAM section 4200.13—.15, auditors develop various generalized materials as aids for documenting the internal control structure and assessing control risk. Many of these aids consist of questions or statements about particular policies or procedures but do not include specific internal control structure objectives. Some materials, however, include statements of specific internal control structure objectives in addition to the traditional questions or statements on policies and procedures. The number and degree of detail of the sets of objectives included in these materials vary. For example, they range in number from about 40 to over 100. These variations depend on the needs and preferences of the auditors who developed the materials.

.030 The illustrative material in this section includes 62 specific internal control structure objectives accompanied by related questions concerned with how the objectives may be accomplished. In a number of instances the questions require a comment rather than a simple yes or no answer; these instances should be self-evident. Because some policies and procedures may accomplish more than one objective, there are instances when a group of questions is associated with two or more objectives. Likewise, there is some repetition among the various groups of questions associated with different specific objectives. Some of the questions are of a general nature and are accompanied by examples of more specific policies and procedures.

.040 A firm should develop or adopt guidance material which is appropriate for its own needs and preferences. In any event, users of this illustrative material or other such material must use professional judgment and be alert for important matters in a particular set of circumstances which may not be covered in the illustrative material. For example, some companies may have developed additional specific internal control structure objectives to meet special circumstances. Also, some of the specific internal control structure objectives included in generalized material may not be applicable to some companies because of the absence of certain types of transactions.

#### **I. Control Environment**

##### **.050 A. Management Philosophy and Operating Style**

###### *Questions—Policies and Procedures*

1. Does management have clear objectives in terms of budget, profit, and other financial and operating goals?
2. Are such policies:
  - a. Clearly written?
  - b. Actively communicated throughout the entity?

- c. Actively monitored?
- 3. Does management adequately consider the potential effects of taking large or unusual business risks prior to doing so?
- 4. Are business risks adequately monitored?

**.060 B. Organizational Structure***Objective*

- Definitions of responsibilities and authority assigned to specific individuals permit identification of whether persons are acting within the scope of their authority.

*Questions—Policies and Procedures*

- 1. Is the organization of the entity clearly defined in terms of lines of authority and responsibility?
- 2. Does the entity have a current organization chart and related materials such as job descriptions and lists of particular individuals which clearly identify:
  - a. The responsibilities and authority assigned to senior management personnel?
  - b. Individuals specifically authorized to initiate and execute transactions?
  - c. Individuals with specific responsibility for custody of various classifications of assets?
  - d. Individuals with specific responsibility for financial control functions?
- 3. Are policies and procedures for authorization of transactions established at an adequately high level?
- 4. Are such policies and procedures adequately adhered to?

**.070 C. Audit Committee***Questions—Policies and Procedures*

- 1. Does the board of directors have an audit committee?
- 2. Does the audit committee take an active role in overseeing the entity's accounting and financial reporting policies and practices?
- 3. Is this evidenced by:
  - a. Regularly held meetings?
  - b. The appointment of members with adequate qualifications?
- 4. Does the audit committee:
  - a. Adequately assist the board of directors in meeting its fiduciary responsibilities?
  - b. Adequately assist the board in maintaining a direct line of communication with the entity's internal and external auditors?

**.080 D. Methods of Assigning Authority and Responsibility***Questions—Policies and Procedures*

- 1. Does the entity have a written code of conduct and conflict of interest requirements?
- 2. Are the code and requirements actively enforced?

3. Are authority and responsibility to deal with organizational goals and objectives, operating functions, and regulatory requirements adequately delegated?
4. Are employees given job descriptions which delineate specific duties, reporting relationships, and constraints?
5. Has the entity developed computer systems documentation which indicates the procedures for authorizing transactions and approving systems changes?

**.090 E. Management Control Methods***Questions—Policies and Procedures*

1. Are there regular meetings of the board of directors (or comparable bodies) to set policies and objectives, review the entity's performance and take appropriate action, and are minutes of such meetings prepared and signed on a timely basis?
2. Has the entity established planning and reporting systems that set forth management's plans and the results of actual performance?
3. Do the planning and reporting systems in place:
  - a. Adequately identify variances from planned performance?
  - b. Adequately communicate variances to the appropriate management level?
4. Does the appropriate level of management:
  - a. Adequately investigate variances?
  - b. Take appropriate and timely corrective action?
5. Does the entity have established policies for developing and modifying accounting systems and control procedures?

**.100 F. Internal Audit Function***Questions—Policies and Procedures*

1. Does the entity have an internal audit function?
2. If an internal audit function is present:
  - a. Are the internal auditors independent of the activities they audit?
  - b. Is the internal audit function adequately staffed in terms of the number of employees, and their training and experience?
  - c. Do the internal auditors document the internal control structure and perform tests of controls?
  - d. Do they perform substantive tests of the details of transactions and account balances?
  - e. Do they document the planning and execution of their work by such means as audit programs and working papers?
  - f. Do they render written reports on their findings and conclusions?
  - g. Are their reports submitted to the board of directors or to a committee thereof?
3. Does management take adequate and timely actions to correct conditions reported by the internal audit function?

4. Does the internal audit function follow up on corrective actions taken by management?

#### **.110 G. Personnel Policies and Procedures**

##### *Questions—Policies and Procedures*

1. Does the entity:
  - a. Adequately plan for staff needs?
  - b. Employ sound hiring practices, including background investigations, where appropriate?
2. Are employees adequately trained to meet their job responsibilities?
3. Does the entity systematically evaluate the performance of employees?
4. Is good performance appropriately rewarded?
5. Does the entity timely dismiss employees for critical violations of control policies?
6. Are employees in positions of trust:
  - a. Bonded?
  - b. Required to take mandatory vacations?

## **II. Accounting System**

#### **.120 A. General Accounting**

##### *Objectives*

- Accounting policies and procedures, including selection among alternative accounting principles, are determined in accordance with management's authorization.
- Access to the accounting and financial records is limited to minimize opportunities for errors and irregularities and to provide reasonable protection from physical hazards.
- Accounting entries are initiated and approved in accordance with management's authorization.
- All accounting entries are appropriately accumulated, classified, and summarized in the accounts.

##### *Questions—Policies and Procedures*

1. Does the entity have adequate written statements and explanations of its accounting policies and procedures?

(Written accounting policies and procedures may include such matters as:

- (i) Chart of accounts accompanied by explanations of the items to be included in the various accounts.
- (ii) Identification and description of the principal accounting records, recurring standard entries, and requirements for supporting documentation. For example, this may include information about the general ledger and journal, and the subsidiary transaction registers, accounts, and detail records for each of the various significant classes of transactions.
- (iii) Expression of the assignment of responsibilities and delegation of authority including identification of the individuals or positions that have authority to approve various types of recurring and non-recurring entries.

(iv) Explanations of documentation and approval requirements for various types of recurring and non-recurring transactions and journal entries. Documentation requirements, for example, would include the basis and supporting computations required for adjustments and write-offs.

(v) Instructions for determining an adequate cutoff and closing of accounts for each reporting period.)

2. Is responsibility assigned for initiation and approval of revisions in the accounting policies and procedures?
3. Are the entity's accounting policies and procedures adequately communicated to appropriate personnel (for example, by distribution of written instructions and manuals to persons who need them)?
4. Does the principal accounting officer of the entity have adequate authority over accounting employees and principal accounting records at all locations?

(Accounting employees of an operating division or subsidiary may report to the operating manager in charge of the division or subsidiary. In these situations it is especially important that those responsible for accounting and reporting at the divisional or subsidiary level be fully advised of the accounting and reporting policies they are expected to follow.)

5. Is maintenance of the general ledger performed by persons whose duties do not include:
  - a. Direct access to assets such as handling cash receipts, custody of marketable securities, receiving of purchased goods, and shipping of finished product?
  - b. Performance of functions which provide indirect access to assets such as signing checks, approving invoices, approving purchase orders, authorizing production, extending credit, and approving sales orders?
  - c. Maintenance of subsidiary ledgers and records?
6. Is access to the general ledger and related records restricted to those who are assigned general ledger responsibilities?
7. Are there adequate facilities for custody of the general ledger and related records?

(Examples of such facilities include fire-resistant locked cabinets, vaults, physical barriers, separate rooms, limited access to work areas, alarms, and other detection devices.)

8. Is appropriate insurance coverage maintained in accordance with management's authorization?

(Such insurance may include loss of records coverage and fidelity bonding of employees in positions of trust.)

9. Are all journal entries reviewed and approved by designated individuals at appropriate levels in the organization?

(The levels at which journal entries are reviewed and approved will usually vary depending on whether the entries are recurring or non-recurring, routine or unusual, accumulations of routine expected transactions or adjustments of balances requiring estimates and judgments.)

10. Are all journal entries adequately explained and supported?

(Explanation and support for an entry should be sufficient to enable the person responsible for its review and approval to reasonably perform this function.)

11. Are the individuals designated to review and approve journal entries independent of initiation of the entries they are authorized to approve?

12. Do all journal entries include indication of approval in accordance with management's general or specific authorization?
13. Are all accounting entries subject to the controls over completeness of processing?  
(Examples of controls over completeness of processing include pre-numbering of journal vouchers and accounting for all numbers used, accumulation of control totals of dollar amounts debited and credited, and standard identification numbers for recurring standard accounting entries.)
14. Do all journal entries include adequate identification of the accounts in which they are to be recorded?
15. Are there adequate detailed records to support entries regarding:
  - a. Amortization of prepaid expenses, deferred charges, and intangible assets?
  - b. Revenue recognition of deferred income?
  - c. Liability accruals and provisions relating to such matters as product warranties?
  - d. Provisions and liabilities for income taxes and other taxes?
  - e. Liability accruals and provisions for such long-term agreements as pension plans and deferred compensation arrangements?
16. Are adequate accounts and records maintained so that adjustments and write-offs made to account balances do not impair accountability for actual amounts?  
(Examples are use of contra (allowance) accounts to accumulate valuation adjustments of asset balances, and use of memorandum accounts to control bad debts which have been written off.)

### **.130 B. Preparation of Financial Statements**

#### *Objectives*

- The general ledger and related records permit preparation of financial statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements and reports.
- Individuals at appropriate levels in the organization consider sufficient, reliable information in making the estimates and judgments required for preparation of financial statements including related disclosures and other externally reported financial information.
- Financial statements including related disclosures are prepared and released in accordance with management's authorization.

#### *Questions—Policies and Procedures*

1. Are the general ledger accounts arranged in orderly groupings which are conducive to efficient statement preparation?
2. Are financial reports of consolidated divisions, subsidiaries and affiliates prepared in prescribed formats which are conducive to efficient combination and consolidation?
3. Are there adequate instructions and procedures for statement preparation?  
(Instructions and procedures, for example, may include the following:
  - (i) Written financial statement closing schedule with assignment of specific preparation and review responsibilities.

- (ii) Standard forms and accompanying instructions that identify for such entities as branches, divisions, and subsidiaries the data they are to report (for example, consistent groupings and identification of intercompany amounts).
  - (iii) Accumulation of information on intercompany transactions.
  - (iv) Accumulation of information for disclosure in notes to financial statements.)
4. Are there adequate detailed records and procedures (for preparation and review) for—
    - a. Entries to develop consolidated financial statements such as eliminations and recording of goodwill and/or minority interest?
    - b. Reclassification entries?
  5. Are policies and procedures adequate for informing appropriate levels of management on a timely basis of—
    - a. Significant, unusual, or nonrecurring transactions or events and considerations concerning their accounting recognition?
    - b. Requirements of existing and new accounting rules, and of the rules and regulations of appropriate regulatory bodies?
  6. Are estimates of net realizable value of assets and related adjustments to provide valuation allowances, and/or to write down asset balances, reviewed and approved by designated individuals at appropriate levels in the organization who are independent of the persons originating such estimates and adjustments?
  7. Are procedures adequate for the review and comparison of financial statement working papers to source data and a comparison of elimination, and reclassification entries to those made in prior periods?
  8. Are financial statements subjected to overall review, including comparisons with the prior period and budgeted amounts, by appropriate levels of management before the statements are approved for issuance?

#### **.140 C. Identified Significant Classes of Transactions**

1. Revenue Cycle (Revenue, Receivables, and Cash Receipts)?
2. Expenditures Cycle (Purchases, Accounts Payable, Payroll, and Cash Disbursements)?
3. Production (Conversion) Cycle (Production Costs, Inventories, Property, and Equipment)?
4. Financing Cycle (Investments, Borrowings, Equity, Cash Collections, and Disbursements)?

### **III. Revenue Cycle**

#### **A. Revenue and Receivables**

##### **.150 Sales Orders**

###### *Objectives*

- The types of goods and services to be provided, the manner in which they will be provided, and the customers to which they will be provided are in accordance with management's authorization.
- The prices and other terms of sale of goods and services are established in accordance with management's authorization.



*Questions—Control Policies and Procedures*

1. Do policies and procedures for acceptance and approval of sales orders appear clearly defined and adequately communicated for:
  - a. Standard goods and services?
  - b. Nonstandard goods and services?
  - c. Unusual delivery arrangements?
  - d. Export sales?
  - e. Sales to related parties?
2. Is responsibility clearly assigned for approval of sales orders (customer acceptance, credit clearance, and other terms of sale) before shipment or performance?
3. Are sales orders approved in accordance with management's general or specific authorization before shipment or other performance concerning:
  - a. Customer?
  - b. Description and quantities?
  - c. Price?
  - d. Other terms of sale (for example, discounts, warranties, time commitments)?
  - e. Credit (account balance limits)?

(In some instances, these matters may be recorded in computer stored master files. In these instances, consideration should be given to controls over the integrity and timely updating of the files.)

4. Are all approved sales orders recorded on appropriate forms (shipping orders, work orders, etc.) which include indication of proper approval and are subject to:
  - a. Pre-numbering?
  - b. Accounting for all forms used?
  - c. Recording in detail?

(For example, listing in a register or log, or retention of copies of all sales orders issued in a file.)

- d. Timely communication to persons who perform the shipping or service function?
5. Are there appropriate procedures for approval of "No charge" services and services performed under a warranty?
6. Are unfilled sales commitments periodically reviewed?
7. Is current information on prices, and policies on such matters as discounts, sales taxes, freight, service, warranties and returned goods clearly communicated to sales and billing personnel?

(For example, such information may be communicated through approved sales catalogs, sales manuals or authorized price lists.)

8. Is there timely communication of salesmen's commission rates to persons performing the sales and accounting functions?

(For example, approved commission schedules.)

### **.160 Credit**

#### *Objective*

- Credit terms and limits are established in accordance with management's authorization.

#### *Questions—Control Policies and Procedures*

1. Do policies on acceptance of credit risk appear clearly defined and adequately communicated?
2. Is the credit of prospective customers investigated before it is extended to them?
3. Is there periodic review of credit limits?
4. Are persons who perform the credit function independent of sales, billing, collection, and accounting functions?
5. Do persons who perform the credit function receive timely information about past due accounts?
6. Is there timely communication of credit limits and changes of credit limits to persons responsible for approving sales orders?

### **.170 Shipments**

#### *Objectives*

- Goods delivered and services provided are based on orders which have been approved in accordance with management's authorization.
- Deliveries of goods and rendering of services result in preparation of accurate and timely billings.

#### *Questions—Control Policies and Procedures*

1. Are goods shipped or services rendered based on documented sales or work orders which include indication of approval in accordance with management's authorization?
2. Are shipping documents prepared for all shipments?
3. Are shipping documents subjected to:
  - a. Pre-numbering?
  - b. Accounting for all shipping documents issued?
  - c. Recording in detail? (For example, listing in a register or log, or retention of copies of all shipping documents issued in a file.)
  - d. Timely communication to persons who physically perform the shipping function?
  - e. Timely communication to persons who perform the billing function?
  - f. Timely communication to persons who perform the inventory control function?(In some systems, copies of the sales order may serve as shipping documents.)
4. Do shipping documents provide indication of:
  - a. Adequate cross-reference to the applicable properly approved sales order?
  - b. Customer identity?

- c. Location to which shipment is made?
  - d. Description and quantities of goods shipped?
  - e. Date of shipment?
  - f. Means of shipment (carrier, etc.)?
  - g. Indication of receipt?
5. Are persons who perform the shipping function independent of the sales, billing, cash and accounting functions?
  6. Is access to finished goods and merchandise restricted so that withdrawals of inventory are based only on properly approved sales orders?
  7. Are quantities of goods shipped verified, for example, by double counting or comparison with independent counts by common carriers?
  8. Are shipping and performance documents reviewed and compared with billings on a timely basis to determine that all goods shipped or services rendered are billed and accounted for?

#### **.180 Billings and Records**

##### *Objectives*

- Sales and such related transactions as commissions and sales taxes are based on deliveries of goods or rendering of services and recorded at the correct amounts and in the appropriate period and are properly classified in the accounts.
- Sales related deductions and adjustments are made in accordance with management's authorization.

##### *Questions—Control Policies and Procedures*

1. Are sales invoices prepared for all shipments of goods or services rendered (including purchases which are shipped directly to customers)?  
  
(In some situations, it is practical to have posting of sales orders include simultaneous preparation of such related forms as shipping orders, billings, and if applicable, salesmen's commission advices.)
2. Are billing and invoice preparation functions performed by persons who are independent of the selling (soliciting and receiving orders from customers), credit, and cash functions?
3. Are all sales invoices:
  - a. Pre-numbered?
  - b. Accounted for to determine all invoices are recorded?
  - c. Matched with properly approved sales orders?
  - d. Matched with shipping documents?
  - e. Traced to authorized current source information on prices and terms (for example, price lists, schedules, catalogues, or computer stored master files)?
  - f. Checked for clerical accuracy by recomputation of extensions and footings?
  - g. Recorded promptly?
4. Are sales invoices listed in detail?

(For example, the listing may be a sales journal, file of invoice copies, or computer prepared transaction file.)

5. Are there suitable chart of accounts, standard journal entries, control accounts and subsidiary records for recording, classifying and summarizing revenues, receivables, collections and such related items as commissions, and provision of allowances for doubtful accounts and product warranties?

6. Is there a proper cutoff of sales and sales adjustments at month end?

(For example, adjustments for shipments not invoiced to customers, sales invoices not recorded, and sales returns or credit adjustments not recorded.)

7. Are all credit memos (for example, adjustments, allowances and returns):

- a. Pre-numbered and all numbers accounted for?
- b. Matched when applicable with receiving reports for returns?
- c. Approved by a responsible employee other than the person initiating preparation of the credit memo?
- d. Recorded promptly?

8. Are commissions based on rates which are in accordance with management's general or specific authorization?

9. Is the accounts receivable subsidiary ledger reconciled monthly to the general ledger control account?

10. Are monthly statements and specific billings sent for trade receivables:

- a. Reviewed by a responsible employee who is independent of the accounts receivable and cash functions?
- b. Mailed by a responsible employee who is independent of the accounts receivable and cash functions?

11. Is an aging schedule or schedule of past due accounts prepared monthly by someone independent of the billing and cash receipts functions?

12. Does the credit manager review monthly aging schedules or listings of past due customer accounts and investigate delinquent accounts and unusual items on a timely basis?

13. Is there documentation of review and analysis of accounts receivable balances to determine valuation allowances (for doubtful accounts) and any specific balances to be written-off?

14. Are valuation allowances and write-offs approved by a responsible employee?

15. Are written-off accounts receivable subject to memorandum control and follow-up by an employee independent of the cash receipts function?

16. Are written-off accounts receivable turned over to lawyers or collection agencies?

**B. Cash Receipts <sup>1</sup>****.190 Processing Collections***Objectives*

- Access to cash receipts and cash receipts records, accounts receivable records, and billing and shipping records is controlled to prevent or detect, on a timely basis, the taking of unrecorded cash receipts or the abstraction of recorded cash receipts.
- Detail transaction and account balance records are reconciled, at reasonable intervals, with applicable control accounts and bank statements for timely detection and correction of errors.

*Questions—Control Policies and Procedures*

1. Is the mail opened by a person(s) whose duties do not involve any shipping, billing, accounts receivable detail, general ledger, invoice processing, payroll and cash disbursement functions?
2. Does the person(s) who opens the mail:
  - a. Place restrictive endorsements on all checks as received so they are for deposit only to the bank accounts of the company?
  - b. List or otherwise obtain control (for example, by photocopying) over all remittances and prepare totals at least daily?
  - c. Forward all remittances to the person who prepares and makes the daily bank deposit?
  - d. Forward the total of remittances to persons independent of physical handling of remittances and accounts receivable detail functions for subsequent comparison with the authenticated duplicate deposit slip and control over postings to subsidiary records?

(In lock box arrangements, customers would mail their remittances to a post office box controlled by the company's bank which would have responsibility for functions 2a-2d.)
3. Are receipts of currency controlled by cash registers and/or pre-numbered cash receipt forms?
  - a. If cash registers are used, is a copy of the tape given to the customer as a receipt, and:
    - (1) Is the key to the cash register tape compartment in the custody at all times of a responsible employee other than the cash register operator(s)?
    - (2) Are readings of the register periodically taken and compared with the cashier's records of receipts by a responsible employee other than the cash register operators?
  - b. If pre-numbered receipts are used for currency collections:
    - (1) Is a copy given to the payor as a receipt?
    - (2) Are all pre-numbered receipts accounted for by a person(s) other than the person(s) handling cash received and balanced with the daily cash received?
  - c. If cash collections are for payments on account, is adequate information given for accurate posting to accounts receivable detail?

---

<sup>1</sup> The illustrative internal control structure objectives and related questions for the cash receipts sections of the revenue cycle (AAM section 4400.190—.200) are duplicated in AAM section 4400.500—.510 because some accountants may prefer to consider them as part of a financing (treasury) cycle.

- d. If significant cash sales are made (as in a retail store) are spot checks made to determine that cashiers are following prescribed procedures?
4. Are currency receipts forwarded daily to the person who prepares the daily bank deposit?
5. Is a summary listing of daily currency receipts forwarded to a person(s) independent of physical handling of remittances and accounts receivable detail functions?
6. Do areas involving physical handling of cash appear reasonably safeguarded?  
(For example, protective windows, vaults, cashier cages, etc.)
7. Are each day's receipts (by mail and over the counter) except for post-dated items deposited intact daily?
8. Are post-dated items segregated on daily detail listings of remittances to aid in control of total items received?
9. Are all employees who handle receipts adequately bonded?
10. Are banks instructed not to cash checks and other instruments (for example, drafts, money orders, etc.) drawn to the order of the company?
11. Does company policy prohibit the cashing of any accommodation checks (for example, personal and payroll checks) out of collections?
12. Are local bank accounts used for branch office collections subject to withdrawal only by the home office?
13. Are banks instructed to deliver charged back deposit items (such as checks returned because of insufficient funds) directly to an employee independent of physical handling of cash receipts and posting of accounts receivable detail?
14. Are bank chargebacks received directly from the bank and investigated by a person independent of:
  - a. Physical handling of collections?
  - b. Posting accounts receivable subsidiary detail?
15. Are entries to the cash receipts journal compared with:
  - a. Duplicate deposit slips authenticated by the bank?
  - b. Deposits per the bank statements?
  - c. Listings prepared (initial control) when mail is opened?
16. Are the comparisons described in item 15 above made by a person(s) whose duties do not include cash receipts and accounts receivable functions?

## **.200 Recording Collections**

### *Objective*

- All cash receipts are recorded at the correct amounts in the period in which received, and are properly classified and summarized.

### *Questions—Control Policies and Procedures*

1. Is information captured from remittances (by mail and over the counter) adequate for accurate posting of credits to individual accounts receivable subsidiary records or to classifications concerning such other sources as investment income, rents, sales of property or scrap, and proceeds of financing?

(This information, for example, may be included on the listing prepared when the mail is opened, remittance advices which accompany customers' checks, detachable stubs from billings, photocopies of checks, copies of pre-numbered receipts issued for currency collections, etc.)

2. Are details of daily collections balanced with the total credits to be distributed to appropriate general ledger accounts and to the total collections for the day before posting to the subsidiary records?
3. Do postings of the general ledger control accounts and subsidiary records include the date on which the remittance was received?
4. Are postings to the general ledger control accounts made by a person(s) independent of:
  - a. Physical handling of collections?
  - b. Posting accounts receivable subsidiary detail?
5. Are details of collections posted to subsidiary accounts receivable records by a person(s) independent of:
  - a. General ledger functions?
  - b. Physical handling of collections?
  - c. Receipt and investigation of bank chargebacks?

#### IV. Expenditures Cycle

##### A. Purchases and Accounts Payable

##### .210 Purchases

###### *Objectives*

- The types of goods, other assets, and services to be obtained, the manner in which they are obtained, the vendors from which they are obtained, the quantities to be obtained and the prices and other terms are initiated and executed in accordance with management's general or specific authorization.
- Adjustments to vendor accounts and account distributions are made in accordance with management's general or specific authorization.

###### *Questions—Control Policies and Procedures*

1. Are all purchases based on requisitions which have been approved in accordance with management's authorization?

(For example, management's authorization may be general in that requisitions for certain types of purchases may be based on automatic reorder points which were previously approved. Management's authorization may be specific in that only specific employees may be authorized to approve requisitions for certain types of purchases.)

2. Are purchases made in accordance with management's prescribed guidelines for vendor acceptability?

(For example, guidelines for vendor acceptability may be based on such considerations as past performance, reputation, and credit standing; ability to meet delivery, quality, and service specifications; price competitiveness; legal restrictions; and policies on related party transactions. Lists of approved vendors may be developed based on such acceptability guidelines. Competitive bids may be required for items over predetermined dollar amounts from a list of several designated major vendors.)

3. Are written purchase orders used for all commitments and do those orders include the vendor description, quantity, quality, price, terms, and delivery requirements for the goods or services ordered?

4. Are all purchase orders, before issuance, approved by specific individuals or classes of individuals designated by management?
5. Are all purchase orders pre-numbered?
6. Are all purchase orders routinely accounted for?
7. Are all purchase orders listed in detail?  
(Examples include a register, log, computer tabulation, or file of copies of issued order forms.)
8. Is there a record of open purchase commitments?  
(Examples include periodic routine listings of open items prepared from a register, a file of open order copies, a computer master file of open orders.)
9. Is the purchasing function independent of receiving, shipping, invoice processing, and cash functions?
10. Is custody of unissued purchase order forms adequate to prevent their misuse?
11. Are open purchase orders periodically reviewed and investigated?

## **.220 Receiving**

### *Objectives*

- All goods, other assets and services received are accurately accounted for on a timely basis.
- Only authorized goods, other assets, and services are accepted and/or paid for.

### *Questions—Control Policies and Procedures*

1. Are all goods received inspected for condition and independently counted, weighed or measured to provide for comparison with the applicable purchase order?
2. Is there evidence that all services received are evaluated for quality and completeness?
3. Are procedures adequate for timely communication concerning shortages or damaged goods?
4. Are receiving reports prepared promptly for all goods received?  
(For example, copies of purchase orders with the quantities blanked out may serve this purpose. Receiving reports may also be used to record such matters as receipt of pieces of leased equipment.)
5. Do receiving reports provide for recording of:
  - a. Description, quantity, and acceptability of goods or services received?
  - b. Date on which the goods or services are received?
  - c. Signature of the individual approving the receipt?
6. Are receiving reports subjected to the following:
  - a. Pre-numbering?
  - b. Listing in detail?  
(For example, a complete set of file copies in numerical or chronological sequence, a receiving log, etc.)
  - c. Accounting for all receiving reports used?



- d. Distribution of copies for timely matching with purchase orders and vendor's invoices and, if applicable, timely maintenance of perpetual inventory records?
7. Are receiving functions performed by designated employees who are independent of the purchasing, shipping, invoice processing, and cash functions?
8. Is there a separate inspection function?

### **.230 Invoice Processing**

#### *Objectives*

- Only authorized goods, other assets and services received are paid for.
- Amounts payable for goods and services received are accurately recorded at the correct amounts in the appropriate period and are classified in the accounts to:
  - (1) Permit preparation of reports and statements in conformity with generally accepted accounting principles or other criteria.
  - (2) Maintain accountability for costs incurred.
- Access to purchasing, receiving, and accounts payable records is suitably controlled to prevent or detect within a timely period duplicate or improper payments.

#### *Questions—Control Policies and Procedures*

1. Are vendors' invoices processed by designated employees who are independent of the purchasing, receiving, shipping, and cash functions?
2. Are all vendors' invoices received directly by the designated employees (accounts payable department) who perform the invoice processing function?
3. Is control established over all invoices received?

(For example, control may be established over invoices received by prompt matching with a pre-numbered internally prepared document such as a purchase order and assignment of that number to the invoice. Another approach may consist of assignment of a voucher number and entry into a register.)
4. Are duplicate invoices conspicuously stamped or destroyed as a precaution against duplicate payment?
5. Are there a suitable chart of accounts and established guidelines for assigning account distributions to processed invoices?
6. Are vendors' invoices, prior to payment, compared in detail to:
  - a. Purchase orders?
  - b. Receiving reports?
  - c. Evidence of direct shipment to customers?

(For example, copy of vendor's shipping document or acknowledgment of receipt by the customer)
  - d. Debit memoranda?
  - e. Evaluation reports on services rendered?
7. Are vendors' invoices, prior to payment, reviewed for correctness of:
  - a. Clerical accuracy (extensions and footings)?

- b. Freight charges?
  - c. Account distribution?
8. Is there documented evidence that invoices have been subjected to prescribed processing routines, assigned specific account distributions and approved before payment?
- (Examples include use of a block stamp which has been initialled or signed, attachment of a completed voucher form, attachment of copies of the purchase order and receiving report, and routine annotations on the invoice.)
9. Are all available discounts taken?
10. Are processed invoices and supporting documents approved by designated employees before payment?
11. Are there procedures for periodic review and investigation of unprocessed invoices, unmatched purchase orders, and unmatched receiving reports which provide for appropriate follow-up and appropriate financial statement accruals?
12. Are approved debit memos used to notify vendors of goods returned and other adjustments of their accounts?
13. Are processed invoices listed in detail to facilitate timely determination of accounts payable and related account distribution of filled purchase commitments?
- (For example, entries in a voucher register and periodic preparation of unpaid voucher listings, computer prepared listings of transaction detail and master files for vendor accounts, files of unpaid processed invoices, etc.)
14. Are accumulation of processed invoices and follow-up of unmatched purchase orders and receiving reports adequate to result in a proper cutoff for financial reporting purposes?
15. Is accounts payable detail periodically reconciled with the control accounts at reasonable intervals?
16. Are vendors' statements reviewed for overdue items and reconciled with accounts payable detail?
17. Is there independent follow-up of such matters as overdue items on vendors' statements, payment requests, and complaints?
18. Are employee expense accounts
- a. Prepared in accordance with criteria set by management?
  - b. Submitted promptly?
  - c. Adequately supported?
  - d. Approved before payment?

**B. Payroll****.240 Authorization of Wages, Salaries, Withholdings, and Deductions Objectives***Objectives*

- Employees are hired and retained only at rates, benefits and perquisites determined in accordance with management's (board of directors, if appropriate) general or specific authorization.
- Payroll withholdings and deductions are based on evidence of appropriate authorization.

*Questions—Control Policies and Procedures*

1. Are all new hires, rates of pay and changes thereto, changes in position, and separations based on written authorizations in accordance with management's criteria?  
(Management's criteria, for example, may include—
  - (i) support for such authorizations by written personnel requisitions which have been initiated and approved at designated levels of management,
  - (ii) conformity of pay rates with previously approved wage and salary schedules, and
  - (iii) appropriate investigation of the job candidate's background.)
2. Are methods for determining premium pay rates for such matters as overtime, night shift work, and production in excess of certain quotas based on written authorization in accordance with management's criteria?  
(Such written authorization may, for example, consist of a schedule based on a labor agreement and/or management policy statements.)
3. Are all employee benefits and perquisites granted in accordance with management's authorization?  
(Employee benefits may be generally authorized as, for example, under a pension plan applicable to a number of employees or specifically authorized as in a deferred compensation agreement with a particular individual authorized by the board of directors.)
4. Are appropriate written authorizations obtained from employees for all payroll deductions and withholding exemptions?
5. Are personnel files maintained on individual employees which include appropriate written authorizations for rates of pay, payroll deductions, and withholding exemptions?
6. Are the following reported promptly to employees who perform the payroll processing function:
  - a. Wage and salary rates resulting from new hires, rate changes, changes in position, and separations?
  - b. Changes in authorized deductions and withholding exemptions?

**.250 Preparation and Recording***Objectives*

- Compensation is made only to company employees at authorized rates and for services rendered (hours worked, piecework, commissions on sales, etc.) in accordance with management's authorization.
- Gross pay, withholdings, deductions, and net pay are correctly computed based on authorized rates and services rendered and properly authorized withholding exemptions and deductions.
- Payroll costs and related liabilities are correctly accumulated, classified, and summarized in the accounts in the appropriate period.
- Comparisons are made of personnel, payroll, and work records at reasonable intervals for timely detection and correction of errors.

*Questions—Control Policies and Procedures*

1. Do employees who perform the payroll processing function receive timely notification of:
  - a. Wage and salary rates resulting from new hires, rate changes, changes in position, and separations?

- b. Changes in authorized deductions and withholding exemptions?
- 2. Is gross pay determined using authorized rates and:
  - a. Time or attendance records for employees paid by the hour or by salary?
  - b. Piecework records for employees whose wages are based on production?
  - c. Adequate detail records of sales for commission salesmen?
- 3. Is there a suitable chart of accounts and established guidelines for determining account distributions for wages and salaries and controlling liabilities for payroll deductions and taxes withheld?
- 4. Do records of individual employee time, piecework, and/or commissions on sales—
  - a. Permit computation of gross pay in accordance with management's criteria?
  - b. Include adequate information for distribution of payroll costs or reconciliation with payroll costs charged to particular cost centers in accordance with management's criteria?
  - c. Receive written approval of applicable supervisors or foremen before submission to persons who prepare the payroll?

(Management criteria for determination of gross pay may include such additional considerations as formulas for overtime premium, shift differential premiums and incentive bonuses. In some situations, records of employee time or production may involve charges to several job order or departmental cost centers. Management criteria may also include additional approvals of time or production increments which result in pay over and above certain base amounts.)
- 5. Are total production hours used for determination of gross pay reconciled with production statistics used for cost accounting purposes?
- 6. Are piece rate records reconciled with production records, or are counts spot checked?
- 7. Salesmen's commission records reconciled with recorded sales?
- 8. Are clerical operations in the preparation of payrolls verified by reperformance or reconciliation with independent controls (such as predetermined totals for gross pay and/or net pay) over source data?
- 9. Is a reconciliation prepared of:
  - a. Payroll cost distributions to gross pay?
  - b. Net pay, deductions and withholding to gross pay?
- 10. Are comparisons made at reasonable intervals of pay rates per the payroll with rates per the written authorizations in the personnel files by responsible persons whose duties are independent of the personnel, payroll processing, disbursement, and general ledger functions?
- 11. Are such data as hours worked, piecework, and commission sales used to determine gross pay compared at reasonable intervals with applicable production and sales records by responsible persons whose duties are independent of personnel, timekeeping, payroll processing, disbursement, and general ledger functions?
- 12. Are the results of comparisons made per items 10 and 11 above reviewed by a responsible official and appropriate action taken?

**.260 Disbursements (Payroll) <sup>2</sup>***Objective*

- Net pay and related withholdings and deductions are remitted to the appropriate employees and entities respectively, when due.

*Questions—Control Policies and Procedures*

1. Are payrolls approved in writing by responsible employees before issuance of payroll checks or distribution of cash for net pay?
2. Is net pay distributed by persons who are independent of personnel, payroll preparation, time-keeping, and check preparation functions?
3. For payrolls paid by check, are checks drawn on a separate imprest account, and are deposits equal to the amount of net pay?
4. For payrolls paid in cash:
  - a. Are adequate security precautions taken?
  - b. Does the cash requisition equal the amount of net pay to be distributed as cash?
  - c. Is distribution made by persons independent of payroll preparation functions?
  - d. Are receipts obtained from employees?
5. Is responsibility for custody and follow-up of unclaimed wages assigned to a responsible person independent of personnel, payroll processing, and cash disbursements functions?
6. Are procedures adequate to result in timely and accurate preparation and filing of payroll tax returns and payment of accumulated withholdings and related accrued taxes?

(Examples of procedures include use of a tax calendar or tickler file, instructions and tables for tax return preparation, use of competent tax information services, and appropriate account classifications and subsidiary records to accumulate required information.)

7. Are procedures adequate to result in timely and accurate remittance of accumulated payroll deductions for fringe benefits?

(Examples include timely availability of information on benefit plans and amendments, use of a payment calendar or tickler file, appropriate account classifications and subsidiary records to accumulate required information.)

**.270 Segregation of Functions and Physical Safeguards***Objectives*

- Functions are assigned so that no single individual is in a position to both perpetrate and conceal errors or irregularities in the normal course of his duties.
- Access to personnel and payroll records is limited to minimize opportunities for errors and irregularities.

*Questions—Control Policies and Procedures*

1. Is there adequate separation of duties among employees who perform the following functions:

---

<sup>2</sup> See AAM section 4400.280—.300 (or 4400.520—.540) for additional objectives and questions on cash disbursements.

- a. Written authorization of new hires, pay rates and changes thereto, benefits, changes in position, and separations?
  - b. Maintenance of personnel records?
  - c. Timekeeping and accumulation of piecework and/or commission information?
  - d. Preparation of payrolls?
  - e. Approval of payrolls?
  - f. Cash disbursements?
  - g. General ledger?
2. Do the personnel and payroll records appear reasonably safeguarded?  
(Examples include locked file cabinets, work areas with limited access.)

**C. Cash Disbursements<sup>3</sup>**

**.280 Assignment of Functions**

*Objective*

- Functions are assigned so that no single individual is in a position to both perpetrate and conceal errors or irregularities in the normal course of his duties.

*Questions—Control Policies and Procedures*

1. Is the cash disbursements function performed by persons who are independent of the following functions:
  - a. Purchasing?
  - b. Receiving?
  - c. Invoice processing?
  - d. Payroll preparation and approval?
  - e. Shipping?
  - f. Accounts receivable?
  - g. Cash receipts?
  - h. General ledger?
2. Is there adequate separation of duties within the cash disbursement function among persons who perform the following:
  - a. Control access to unissued checks?
  - b. Prepare checks?
  - c. Sign checks and inspect support?
  - d. Mail checks?

---

<sup>3</sup> The illustrative internal control objectives and questions for the cash disbursements sections of the expenditures cycle (AAM section 4400.280—.300) are duplicated in AAM section 4400.520—.540 because some accountants may prefer to consider them as part of a financing (treasury) cycle.

- e. Maintain custody of petty cash?
- f. Maintain the cash disbursement journal?
- g. Reconcile the bank accounts?

### **.290 Processing Disbursements**

#### *Objectives*

- Disbursements are made only for expenditures incurred in accordance with management's authorization.
- Adjustments to cash accounts are made only in accordance with management's authorization.
- Disbursements are recorded at correct amounts in the appropriate period and are properly classified in the accounts.
- Access to cash and cash disbursements records is restricted to minimize opportunities for irregular or erroneous disbursements.

#### *Questions—Control Policies and Procedures*

1. Are all bank accounts authorized by the board of directors?
2. Are all check signers authorized by the board of directors?
3. Are banks promptly notified of any changes in authorized check signers?
4. Are banks instructed not to cash checks and other instruments (for example, drafts, money orders, etc.) drawn to the order of the company?
5. Are all bank accounts and cash funds subjected to general ledger control?
6. Are all disbursements and bank transfers based on vouchers and check requests which have been approved by responsible employees designated by management?
7. Are all disbursements except from petty cash made by check?
8. Are properly approved supporting documents (processed invoices, purchase orders, receiving reports, etc.) presented with the checks and reviewed by the check signer(s) before signing the checks?
9. Is a mechanical check protector used to inscribe amounts on checks as a precaution against alteration?
10. Are supporting documents for checks properly cancelled to avoid duplicate payment?
11. Are signed checks independently mailed directly after signing without being returned to persons involved in the invoice processing and check preparation functions?
12. Is access to unissued checks limited to designated responsible employees who are independent of the check signing function, including operation of mechanical check signing machines?
13. Are checks pre-numbered and all numbers accounted for?
14. Are all voided checks retained and mutilated?
15. Are all checks promptly recorded when issued and listed in detail (cash disbursements journal, check register, etc.)?
16. Are details of individual disbursements balanced with the totals to be posted to appropriate general ledger account distributions and to total disbursements to be posted to the general ledger control accounts for cash?

17. Is there a written policy which prohibits:
- Drawing checks payable to cash or bearer?
  - Signing or countersigning of blank checks?
18. If dual signatures are required:
- Are the two signers independent of one another?
  - Does each signer determine that the disbursement is supported by approved documentation?
19. If a check signing machine is used:
- Are checks approved before mechanical signing by designated responsible employees who are subject to the same segregation of duties as if they were authorized check signers?
- (Use of a check signing machine allows an entity to delegate authority for approving checks to a greater number of persons than those registered with the bank as authorized signers. However, approval procedures should be sufficient to assure the official whose name is on the signature plate that all mechanically signed checks would have met his approval if he had reviewed and manually signed them himself.)
- Are the keys, signature plate, and operation of the signing machine under control at all times of the official whose signature is on the plate?
  - Are the employees who have custody of the keys, plate, and operate the check signing machine independent of voucher and check preparation functions and denied access to blank checks?
  - Are the checks issued to the machine operator(s) counted in advance and reconciled with the totals of the counting device on the check signing machine by someone other than the machine operator?
- (Control may be strengthened by having a locked compartment on the machine which receives the signed checks and can be opened only by someone independent of the machine operator.)
20. Are cash funds on an imprest basis and:
- Kept in a safe place?
  - Reasonable in amount?
  - Controlled by one custodian who is independent of invoice processing, check signing, general accounting, and cash receipts functions?
  - Periodically counted by someone other than the custodian?
21. Are all disbursements from cash funds:
- Supported by vouchers which are prepared in ink?
  - Approved in accordance with management's authorization?
  - Cancelled to prevent reuse?
  - Subject to a predetermined maximum dollar limit for any individual disbursement?
22. Are reimbursements of cash funds:
- Subject to the same review and approval as processed invoices?
- (See AAM section 4400.230 on invoice processing)



- b. Remitted by checks drawn payable to the order of the custodian of the cash fund?

### **.300 Bank Reconciliations**

#### *Objective*

- Comparison of detail records, control accounts, and bank statements are made at reasonable intervals for detection and appropriate disposition of errors or irregularities.

#### *Questions—Control Policies and Procedures*

1. Are the bank accounts reconciled monthly by an employee(s) who is independent of invoice processing, cash disbursements, cash receipts, petty cash, and general ledger functions?
2. Are bank statements, related paid checks, debit and credit memos received directly from the bank by the employee(s) performing the reconciliations?
3. Does the bank reconciliation procedure include:
  - a. Reconciliation of the balance per bank to balance per the general ledger control account and subsidiary detail records?
  - b. Comparison in detail of deposits per the bank statement with deposits per cash receipts detail records?
  - c. Comparisons in detail of disbursements per bank with the cash disbursements journal (check register) as to date drawn, payee, and amount?
  - d. Comparison of payees with endorsements?
  - e. Follow up of reconciling items and initiation of entries to record such transactions as checks returned for insufficient funds and bank charges?
4. Are old outstanding checks investigated and subjected to proper disposition (in compliance with applicable escheat laws if present)?

## **V. Production (Conversion) Cycle**

### **A. Production Costs and Inventories**

#### **.310 Authorization of Production Activities, Planned Inventory Levels, and Service Capabilities**

#### *Objective*

- All production activity (including planned inventory levels and service capabilities) and accounting therefor is determined in accordance with management's general or specific authorization.

#### *Questions—Control Policies and Procedures*

1. Are the types and quantities of goods to be manufactured and/or services to be provided determined in accordance with management's authorization?

(Some examples of how management may record and communicate its authorization include approval of:

  - (i) Production goals and schedules based on accompanying sales forecasts.
  - (ii) Overall production and inventory control plans.
  - (iii) Establishment of a production control function.
  - (iv) Definitions and policy statements on services to be provided.)

2. Are the methods and materials to be used determined in accordance with management's authorization?  
(Some examples of how management may evidence its authorization include approval of:
  - (i) Product engineering plans and specifications.
  - (ii) Acquisitions and use of property and equipment.
  - (iii) Procedural instructions for services to be provided.))
3. Are planned inventory levels or service capabilities to be maintained determined in accordance with management's authorization?  
(Some examples of how management may evidence its authorization include approval of:
  - (i) Budgeted inventory levels.
  - (ii) Policies on whether to produce for specific customer orders, for stock, or a combination of both.
  - (iii) Predetermined reorder points.
  - (iv) Policies on identification and disposition of excess or obsolete inventory.
  - (v) Planned personnel rosters of individuals with specific knowledge, experience, and skills relating to services to be provided.))
4. Is the scheduling of goods to be produced and/or services to be provided determined in accordance with management's authorization?  
(Some examples of how management may evidence its authorization include approval of:
  - (i) Production schedules and forecasts.
  - (ii) Forecasts of time requirements.
  - (iii) Policies and procedures for budgeting individual job or project orders.))
5. Are all adjustments to inventory and cost of sales made in accordance with management's authorization?
6. Are all dispositions of obsolete or excess inventory or scrap made in accordance with management's authorization?

### **.320 Recording Resources Used in Production and Completed Results**

#### *Objective*

- Resources obtained and used in the production process and completed results are accurately recorded on a timely basis.

#### *Questions—Control Policies and Procedures*

1. Are receiving reports prepared which include adequate information for posting detailed inventory records and allow for summarization into a source for posting inventory control accounts?  
(See AAM section 4400.220, Expenditures Cycle—Receiving, for further illustrative questions on receiving reports.)
2. Are all releases from storage of raw materials, supplies, and purchased parts inventory based on approved requisition documents which:

- a. Include adequate information to be used as a reliable and consistent source for posting detailed inventory records?  
(For example, descriptions, quantities and inventory cost.)
- b. Allow for summarization into a source for maintaining inventory control accounts?
- c. Provide a means (such as prenumbering or batching) of accounting for all requisitions issued?
3. Is authority to approve inventory requisitions assigned to responsible employees whose duties do not include the following:
  - a. Physical custody of raw materials, supplies, and purchased parts inventories?
  - b. Maintenance of detailed inventory records?
  - c. Maintenance of inventory control accounts?
4. Is labor effort (time, cost or both) reported promptly and recorded in sufficient detail to be identified with applicable classifications such as job orders or allocation to units in process, and to provide for:
  - a. Accumulation into reliable and consistent sources for maintaining detail production control and cost accounting records?
  - b. Summarization into a source for posting inventory control accounts?
  - c. Reconciliation with payroll costs charged to the production process?
  - d. A means (such as pre-numbering or batching) of accounting for all labor reports issued?  
(See AAM section 4400.240—.270, Expenditures Cycle—Payrolls, for further illustrative questions on payroll.)
5. Are transfers of completed units from production to custody of finished goods inventory based on approved completion reports which authorize such transfer and:
  - a. Include adequate information to be used for reliable and consistent maintenance of detailed finished goods inventory and reconciliation with applicable materials and labor put into the production process?
  - b. Allow for summarization into a reliable and consistent source for maintaining general ledger control accounts?
  - c. Provide a means (such as pre-numbering or batching) of accounting for all completion reports issued?
6. Do completion reports include indication of approval by designated individuals in accordance with management's criteria?  
(Such criteria may concern completion of prescribed production steps and conformity with prescribed quality standards.)
7. Are there adequate procedures for reporting defective units and scrap resulting from the production process?
8. Are perpetual inventory records maintained of both quantities and dollar amounts for:
  - a. Raw materials?
  - b. Supplies?

- c. Work in process?
  - d. Finished goods?
  - e. Scrap?
  - f. Inventory held by outside parties?  
(For example, bonded warehouses, consignees, subcontractors, suppliers.)
  - g. Inventory held for outside parties?  
(For example, goods billed but not yet shipped, goods held on consignment, materials being processed as a subcontractor, etc.)
9. Are the perpetual records of inventory detail:
- a. Controlled by general ledger accounts?
  - b. Based on documentation of inventory movement and adjustments which has been approved in accordance with management's authorization?
  - c. Adjusted to periodic physical inventories taken annually or on a cycle basis at least once a year?
  - d. Reconciled with the inventory control accounts at reasonable intervals?
  - e. Kept by persons whose duties do not include the following:
    - (1) Custody of the physical stock
    - (2) Maintenance of the general ledger control accounts
    - (3) Authority to requisition withdrawals or other movement of inventory.
10. Is documentation of inventory movement accounted for to determine complete and adequate recording thereof?
11. Are there adequate procedures for identifying and reporting excess, slow-moving, and obsolete inventories?
12. Do the duties of the persons engaged in production, inventory planning, and inventory custody exclude the following functions:
- a. Maintenance of detail inventory records?
  - b. Cost accounting?
  - c. General accounting?

### **.330 Recording Transfers to Customers and Other Inventory Dispositions**

#### *Objective*

- Transfer of finished production to customers and other dispositions such as sales of scrap are accurately recorded on a timely basis.

#### *Questions—Control Policies and Procedures*

1. Are releases of finished goods inventory for delivery to customers based on shipping documents which have been approved in accordance with management's authorization?

(See AAM section 4400.170, Revenue Cycle—Shipments, for further illustrative questions on shipping documents.)

2. Are releases of excess, obsolete, defective or scrap inventory for disposition based on documented instructions which have been approved in accordance with management's authorization?
3. Is authority to approve instructions for the release of inventory assigned to responsible employees whose duties do not include the following:
  - a. Physical custody and handling of inventories including preparation of goods for shipment?
  - b. Maintenance of detailed inventory records?
  - c. Maintenance of general ledger control accounts?
4. Do shipping documents and release documents for such other dispositions as sales of scrap—
  - a. Include adequate information for recording reductions in the detailed inventory records, charges to cost of sales, and cross-reference or connection with source documents used to recognize revenue and the related receivable?

(If practicable, the same document may serve as the source for recognition of revenue and the related receivable and of cost of sales and the related reduction of inventory.)
  - b. Allow for summarization into a source for maintaining the inventory control accounts?
  - c. Provide a means (such as pre-numbering or batching) of accounting for all shipping documents and other release documents issued?

### **.340 Accumulation and Classification of Production and Inventory Costs and Costs of Sales**

#### *Objective*

- Inventory, production costs, and costs of sales are accumulated and classified in the accounts to—
  - (1) permit preparation of statements in conformity with generally accepted accounting principles or any other criteria applicable to such statements.
  - (2) maintain accountability for costs incurred.

#### *Questions—Control Policies and Procedures*

1. Do the chart of accounts and standard journal entries provide adequate general ledger control accounts and subsidiary detail for the following:
  - a. Accumulation and classification of costs of materials, direct labor, and overhead (including indirect labor)?
  - b. Accumulation of information such as the following in sufficient detail and with proper cutoff to provide for adequate determination of inventory costs and cost of goods sold:
    - (1) Quantities of raw materials and supplies used in production?
    - (2) Labor hours and/or machine hours expended?
    - (3) Quantities or units of product produced?
    - (4) Quantities or units of product transferred to customers?

(Accounts and records vary extensively among companies because of such variables as industry, company size, and nature of the production or service process. Examples of techniques to consider in addressing a company's needs include:

- (i) Identification and allocation of costs directly to units or jobs produced and to overhead; application of overhead to units or jobs using a burden rate and a factor such as direct labor hours incurred or units produced.
  - (ii) Use of a job order or process cost system or combination of both, or an allocation of costs incurred to units produced based on units sold and the units in the physical inventories as of the closing and opening of a period.
  - (iii) Identification of costs incurred with departments or cost centers responsible for incurring the particular costs.
  - (iv) Use of departmental or cost center burden rates to apply overhead to production.
  - (v) Use of a standard cost system with investigation of variances.
  - (vi) Account classifications which provide for preparation of reports and statements in conformity with generally accepted accounting principles and, if appropriate, such other criteria as direct costing practices selected by management for internal purposes and statutory accounting practices required by regulatory bodies.)
2. If a cost accounting system is used, is it reconciled at reasonable intervals with the general ledger?
  3. If perpetual records are maintained, are they reconciled at reasonable intervals with the:
    - a. General ledger?
    - b. Cost accounting system?
  4. Are requisitions for materials, supplies, finished goods, and physical transfers of inventory subjected to the following:
    - a. Review to determine that requisitions are completed and approved in accordance with management's authorization?
    - b. Accounting for all requisitions used?  
(For example, by accounting for all numbers pre-assigned to particular types of requisition forms.)
    - c. Summarization of requisitions at reasonable intervals for consistent and timely maintenance of control accounts?
    - d. Accurate and timely recording in the subsidiary detail records?
  5. Are reports of direct and indirect labor effort (for example: job tickets, time cards, etc.) subjected to the following:
    - a. Review to determine that the reports are completed and approved in accordance with criteria authorized by management?
    - b. Accounting for all reports issued?  
(For example, by accounting for all numbers pre-assigned to particular types of reporting forms.)
    - c. Reconciliation with account distribution of payroll for consistent and timely maintenance of the control accounts?

- d. Accurate and timely recording in the subsidiary detail records?
6. Are the detailed inventory records and control accounts adjusted for reports of excess, slow-moving, and obsolete inventories in accordance with management's general or specific authorization?
7. Are burden rates and amounts of overhead applied to production compared at reasonable intervals with actual overhead costs incurred and updated in accordance with management's authorization?
8. For standard cost systems:
  - a. Are standard rates and volume compared at reasonable intervals with actual costs and activity and revised accordingly for changes in underlying conditions?  
  
(For example, comparison of raw material costs with vendors' invoices, standard labor rates with actual rates, standard materials usage and machine hours with product engineering changes, standard labor hours with time studies, etc.)
  - b. Are significant variances investigated and the resulting explanation brought to management's attention on a timely basis?
9. Do the duties of persons who maintain the detailed inventory and cost accounting records exclude the following functions:
  - a. Physical custody and handling of inventories?
  - b. Maintenance of the general ledger control accounts?
10. Is access to the detailed inventory records and control accounts limited to persons responsible for their maintenance, oversight, and internal audit?
11. Are the inventory detail records and control accounts adjusted to physical counts at least annually?

### **.350 Inventory Safeguarding**

#### *Objectives*

- Inventory is protected from unauthorized use or removal.
- Access to inventory, property, cost, and production records is limited to designated individuals in accordance with management authority so that unauthorized dispositions may be prevented or detected within a timely period.

#### *Questions—Control Policies and Procedures*

1. Do physical safeguards of inventory appear reasonably adequate in relation to the materiality of the inventory and its susceptibility to theft?

(Examples include:

- Fenced areas,
- Restricted-access storerooms or vaults,
- Guards,
- Detection and scanning devices (for example, alarms, television cameras),
- Inspection of personnel,
- Independent storeroom clerks,
- Maximum visibility by supervisors and security personnel of work and storage areas.)

2. Does inventory appear reasonably protected from physical deterioration?

(Examples include:

- Shelters and buildings,
- Maintenance of environment at appropriate temperature and humidity,
- Containers and storage facilities.)

3. Are persons responsible for custody of inventory independent of inventory recording, cost accounting, and general accounting functions?
4. Is insurance coverage of the inventory maintained and reviewed in accordance with management's authorization?

### **.360 Physical Counts of Inventory**

#### *Objective*

- Recorded balances of inventory are substantiated and evaluated at reasonable intervals by comparison with and evaluation of actual quantities on hand. (For example, physical counts and review for excess, slow-moving, and obsolete stock.)

#### *Questions—Control Policies and Procedures*

1. Is inventory subjected to physical count at least annually?
2. If the complete physical count is made at other than the fiscal year end are the controls over physical movement (receipts, internal transfers, and shipments) of inventory, accuracy of recording cutoffs and segregation of duties satisfactory for such timing?
3. If counts are made on a cycle basis rather than as complete counts, are all of the following conditions present for classes of inventory subjected to cycle counts?
  - a. Complete and accurate perpetual records which are maintained on a timely basis?
  - b. The nature of the inventory items allows for practicable comparison with perpetual records?
  - c. Adequate control over physical movement of inventories (receipts, internal transfers, and shipments) and accurate recording of cutoffs to provide timely and accurate source data for maintaining the perpetual records and clear identification of classes or groups of items to be counted?
  - d. Sufficient segregation of duties so that errors of omission or commission are prevented or detected promptly?
4. Do detailed written inventory procedures and instructions exist which have been approved in accordance with management's authorization before issuance and use?
5. Do the inventory procedures adequately address the following matters:
  - a. Location and orderly physical arrangement of inventories?
  - b. Identification and description of the inventories by persons familiar with it?
  - c. Segregation and proper identification of goods that are not property of the client, such as customers' goods and goods held on consignment?
  - d. Method of determining quantities such as weight, count or measure?



- e. Recording of items on count sheets or tickets including complete descriptions, identifying codes (serial numbers, model numbers), as well as quantities counted?
  - f. Special considerations for work in process such as identifying stage of completion?
  - g. Identification of stock counted to determine whether all items are counted and to preclude duplicate counting?
  - h. Cutoff of receipts, internal transfers, and shipments?
  - i. Control of physical inventory records, such as pre-numbering of all count sheets, count tickets, and accounting for all numbered records issued and used?
  - j. Identification of slow-moving, obsolete, and damaged items?
  - k. Substantiation of inventories held by others?
  - l. Pricing, extension, and summarization of the physical counts?
  - m. Investigation and disposition of differences between physical counts and detailed inventory records?
- 6. Are physical count procedures supervised by a responsible official whose duties do not include physical custody of inventories and performance of purchasing, receiving, and shipping functions?
  - 7. Are inventory instructions adequately communicated to and understood by persons who perform the physical counts?
  - 8. Are physical counts performed by persons whose duties do not include the following:
    - a. Physical custody of inventories?
    - b. Detailed inventory record keeping (maintaining perpetual records)?
    - c. Maintenance of inventory control account(s)?
  - 9. Is inventory movement adequately controlled during the count so that items are not missed or double-counted because of:
    - a. Receiving activity?
    - b. Internal inventory movement?
    - c. Shipping activity?
  - 10. Are controls over purchases and receiving activity sufficient to result in recording of liabilities for any items included in inventory which have not been paid for?
  - 11. Are controls over sales and shipping activity sufficient to result in exclusion from the physical inventory of any items which have been sold and billed but not yet shipped?
  - 12. Are inventory counts subject to adequate verification such as recounts by persons other than those who made the initial counts or spot checks by others, such as internal auditors?
  - 13. Are pricing, extension, and summarization of the physical counts performed by persons whose duties do not include the following:
    - a. Physical custody of inventories?
    - b. Detailed inventory record keeping?
    - c. Maintenance of the inventory control accounts?

14. Are pricing, extension, and summarization of the physical counts subject to adequate verification such as reperformance by persons other than those who initially performed the tasks on a complete or test basis?
15. Are differences between physical counts and detailed inventory records investigated in accordance with management's authorization before the records are adjusted?
16. Is there documentation of review and analysis of the physical inventory to:
  - a. Conform with the lower of cost or market principle,
  - b. Identify items which are excessive, slow-moving, defective or obsolete,
  - c. Determine the need for adjustments or valuation allowances?
17. Are adjustments of the inventory detail records and control accounts given prior approval in accordance with management's authorization?
18. Are dispositions of obsolete or excess inventories and scrap made in accordance with criteria authorized by management?

## **B. Property and Equipment**

### **.370 Initiation and Execution of Property and Equipment Transactions**

#### *Objective*

- Additions and related accumulation of depreciation or amortization, retirements, and dispositions of property and equipment (owned and leased) are made in accordance with management's authorization.

#### *Questions—Control Policies and Procedures*

1. Is advance approval in accordance with management's criteria required for all property and equipment transactions?

(For significant additions (purchases or leases) approval authority may be kept at such levels as the board of directors. In some closely held entities, authority for such approval may be reserved by the stockholders or partners. Some entities, however, may have a framework of policies and procedures within which general authority for property and equipment transactions within certain dollar limits may be delegated to management levels below the board of directors. It is desirable that such policies be clearly expressed and documented.)
2. Are requests for additions, transfers, major maintenance and repair, retirement and disposition of property and equipment—
  - a. Initiated by designated individuals in accordance with management's authorization?

(These individuals generally are responsible employees or officials in the department which would use the asset.)
  - b. Formally documented, including an adequate description of the proposal, its reasons, and the estimated amount of the transaction?

(Some entities may use standardized forms to document requests for property and equipment transactions including signatures of employees who initiated and approved the request.)
  - c. Reviewed for key considerations in accordance with management's criteria?

(Key considerations may include such issues as:

    - (i) Whether to make or buy the asset.

- (ii) Selection of vendors, prices, and terms including consideration of soliciting competitive bids.
  - (iii) Selection among financing alternatives such as use of internally generated funds, entering debt or lease agreements, and issuing preferred or common stock.
  - (iv) Accounting matters, such as whether the transaction should be capitalized or expensed, classification of leases, determination of estimated useful life, salvage value, and methods of depreciation or amortization.)
- d. Approval at a higher level than the department or official who initiated the request?
3. Are authorizations to execute property and equipment transactions adequately documented?
- (Following are some examples of such documentation:
- (i) Decisions recorded in meetings of the board of directors or finance committee accompanied by relevant detailed proposals and cost-benefit analyses which may be part of the minutes by reference.
  - (ii) Work order forms approved by designated individuals in accordance with clearly stated management criteria.
  - (iii) Contracts and agreements signed by individuals in accordance with appropriately documented designation by the board of directors.)
4. Are procedures adequate for determining that components and services for property and equipment are received or performed?
- (Examples include status or completion reports prepared by architects and engineers and approved in accordance with management's authorization; or transactions processed through the company's normal purchasing procedures. See AAM section 4400.210—.230, Expenditures Cycle—Purchases and Accounts Payable, for additional illustrative inquiries on purchase orders, receiving reports and vendors' invoices.)
5. Are procedures adequate for determining that all dispositions of property and equipment have been executed and proceeds, if any, received in accordance with management's authorization?

### **.380 Recording Property and Equipment and Related Depreciation and Amortization**

#### *Objective*

- Transactions involving property and equipment and related depreciation and/or amortization are accurately recorded, accumulated, and classified in detail and in control accounts to—
  - (1) permit preparation of statements in conformity with generally accepted accounting principles or other criteria applicable to such statements, and
  - (2) maintain accountability for assets.

#### *Questions—Control Policies and Procedures*

1. Are detailed records maintained for the classes of property and equipment (owned and leased) which present:
  - a. Description of specific assets, their location, and if applicable, such specific identification as serial or other control numbers?
  - b. Cost, acquisition date, and date placed in service (if different from acquisition date)?
  - c. Depreciable or amortizable life and method of depreciation or amortization?
    - (1) For financial reporting purposes?

- (2) For tax purposes if different from financial reporting?
- d. Estimated salvage value and amount subject to depreciation or amortization?
- e. Amount of related accumulated depreciation or amortization?
- 2. Are general ledger control accounts maintained for the appropriate classes of owned and leased property and equipment and related depreciation and amortization?
- 3. Are responsibilities for maintaining the detailed property records segregated from those of—
  - a. Maintaining the general ledger control accounts?
  - b. Custody of property and equipment?
- 4. Do persons who maintain the detail records and control accounts receive timely and adequate information about—
  - a. Additions, transfers, retirement from service, and dispositions of property and equipment?
  - b. Depreciable (or amortizable) lives and methods of depreciation or amortization as prescribed in accordance with management's authorization?
- 5. Are the detailed property and equipment records reconciled at reasonable intervals with the control accounts and differences, if any, investigated and resolved in accordance with management's authorization?
- 6. Are depreciable and amortizable lives reviewed at reasonable intervals for adequacy in relation to use or obsolescence based on actual experience?

### **.390 Safeguarding Property and Equipment**

#### *Objective*

- Property and equipment is reasonably safeguarded from loss.

#### *Questions—Control Policies and Procedures*

- 1. Is property and equipment insured in accordance with management's authorization based on appraisals made at reasonable intervals?
- 2. Are items of property and equipment (owned and leased) subject to reasonably adequate physical protection techniques?  
  
(Examples of such techniques include fire alarms and extinguishers, fences, security guards, burglar alarms, limited access, and requisitioning procedures for use of portable equipment, etc.)
- 3. Is responsibility for physical custody of property and equipment assigned to employees whose duties are independent of:
  - a. Maintaining detailed property records?
  - b. General ledger functions?
- 4. Are items of property and equipment (owned and leased) physically inspected at reasonable intervals and compared with the detailed property records?

(This may be done in coordination with appraisals made to determine insurable values.)

5. Are documents of title and property rights, such as deeds and leases, in the custody of a responsible employee whose duties do not include maintenance of the detailed property records or physical custody of the assets?
6. Are documents of title and property rights compared with the detailed property records at reasonable intervals by persons whose duties do not include the following:
  - a. Custody of such documents?
  - b. Maintenance of the detailed property and equipment records?

## VI. Financing (Treasury) Cycle

### A. Investments

#### .400 Authorization of Investment Transactions

##### *Objective*

- The nature and terms of investment transactions (marketable securities, notes receivable, and long-term debt or equity investments) are made in accordance with management's authorization.

##### *Questions—Control Policies and Procedures*

1. Are investment transactions initiated and approved in accordance with management authorization?  
(If investments are infrequent and significant, management may deal with each purchase or sale on a case by case basis with approval exercised by the board of directors or a finance committee. If investment transactions are relatively frequent, management may establish standard policies and procedures for initiation and approval of investment transactions.)
2. Are investment transactions approved before execution by responsible officials other than those who proposed the transactions?  
(For example, a transaction may be proposed by the chief executive officer and executed after authorization and approval by the board of directors. Another example would be purchases of treasury bills by the chief financial officer pursuant to authorization by the board of directors.)
3. Are investment transactions initiated and approved by persons whose duties do not include:
  - a. Accounting for investment transactions?
  - b. Custody of investment securities?
4. Are initiation and approval of investment transactions adequately documented?
5. Are brokers' advices and other evidence of execution of transactions promptly compared with documented authorizations and differences brought to the timely attention of management?

#### .410 Recording and Classifying Investment Transactions

##### *Objective*

- Investment transactions, including accrual and collection of related income, are recorded at the correct amounts in the accounting periods in which they were executed or earned, and properly classified in the accounts.

##### *Questions—Control Policies and Procedures*

1. Are adequate general ledger control accounts maintained for various investment classifications and related income?

2. Are adequate detailed investment records maintained currently including control of related income?
3. Are procedures adequate to determine that investment income (interest, dividends) is properly accrued and promptly collected?  
  
(Examples of these procedures include comparison of interest accrued with terms of the securities or loan agreements and interest income received, or comparison of dividend income with published dividend records or reports by the investee.)
4. Are the detailed investment records reconciled with the general ledger control accounts, including related income, by persons whose duties do not include:
  - a. Maintenance of the detailed investment records?
  - b. Maintenance of the general ledger?
  - c. Physical custody of the investment securities?
5. Are investments and related collateral reviewed and appraised or valued at market at reasonable intervals for comparison with cost valuations and—
  - a. Reporting of the findings to management?
  - b. Determination of need for any valuation allowances?

#### **.420 Physical Safeguards and Custodial Accountability**

##### *Objective*

- Documents evidencing ownership of investments and related collateral, and other investment records are subjected to reasonably adequate physical safeguards and effective custodial accountability procedures.

##### *Questions—Control Policies and Procedures*

1. Are investment securities and related collateral subject to reasonably adequate physical safeguards?  
  
(Examples include use of safe deposit boxes and/or vaults which require two individuals to gain access; custodial accounts with banks and trust companies, and accounts with brokers.)
2. Are investment securities, except for bearer securities, registered in the name of the company or nominees designated in accordance with management's authorization?
3. If an independent custodian is used, has the custodian been approved by the board of directors?
4. Is custody of investment securities held by the company assigned to designated bonded employees whose duties do not include:
  - a. Maintenance of detailed investment records?
  - b. Maintenance of general ledger control accounts?
  - c. Cash receipts and disbursement functions?
5. Is authority to withdraw investment securities from custody limited to written authorization and joint signatures of responsible officials whose duties do not include:
  - a. Custody of investment securities?
  - b. Maintenance of detailed investment records?
6. Are investment securities examined at reasonable intervals and compared with detailed investment records by responsible persons whose duties do not include:

- a. Custody of the investment securities?
- b. Maintenance of the detailed investment records?
- c. Maintenance of the general ledger control accounts?
- d. Cash functions?

**B. Borrowing (Debt and Leases)**

**.430 Authorization of Debt and Other Borrowing Arrangements**

*Objective*

- All debt and other borrowing arrangements (such as leases) are initiated and executed in accordance with management's authorization.

*Questions—Control Policies and Procedures*

1. Are debt and other borrowing arrangements initiated and approved in accordance with management authorization?

2. Are authorizations for specific debt and other borrowings recorded?

(Authorizations may be recorded, for example, as decisions in the minutes of board of directors' meetings, finance committee meetings, or partners' meetings.)

3. Do the authorizations specify:

- a. The officials authorized to negotiate debt and leases?
- b. The maximum commitments such officials can make?
- c. Property which may be pledged to collateralize debt?
- d. Covenants which may be made to obtain the loan or lease?

(Some entities may require that all loan and other borrowing agreements be reviewed by legal counsel before signing.)

4. Are the signatures of two authorized officials required to execute debt instruments or leases?

5. Do procedures appear adequate for initiating proposed debt and lease transactions?

(In some entities, debt and lease transactions may be infrequent and of such significance that management participates directly in the proposal and approval process on a case by case basis using specialized assistance where appropriate. In other entities, there may be regular procedures concerning matters such as:

- (i) Study of alternatives such as debt, lease or equity financing.
- (ii) Review of corporate charter, bylaws, and covenants of existing debt and lease agreements and obtaining appropriate advice from legal counsel.
- (iii) Review of financial forecasts, tax and financial reporting considerations and obtaining appropriate professional advice.)

6. If an agent (generally a bank or trust company) is used for the interest disbursing and redemption functions, have the agent and arrangements been authorized by the board of directors?

**.440 Recording and Classifying Debt and Other Borrowings***Objective*

- Transactions and obligations concerning debt and other borrowing arrangements are promptly and accurately recorded and classified in detail records and control accounts to—
  - (a) permit preparation of financial statements including required disclosures in conformity with generally accepted accounting principles or other criteria applicable to such statements, and
  - (b) provide timely and accurate information as a basis for conforming with payment obligations and other covenants in the applicable agreements.

*Questions—Control Policies and Procedures*

1. Are detailed, timely records maintained of such debt and other borrowings as notes payable, long-term debt, and capitalized leases that include such information as:



- a. Date of inception?
- b. Type of obligation?
- c. Face amount?
- d. Interest rate?
- e. Maturity?
- f. Timing and amount of payments?
- g. Proceeds initially received?
- h. Payments of principal?
- i. Outstanding principal balance?
- j. Accrued interest expense?
- k. Payments of interest?
- l. Outstanding balance of accrued interest payable?
- m. Premium or discount at inception?
- n. Amortization of premium or discount?
- o. Balance of unamortized premium or discount?
- p. Summarized information or collateral and/or restrictive covenants connected with the obligation (such as minimum current ratios and/or debt to equity ratios; restrictions on paying dividends, purchasing property and equipment, and/or entering lease agreements?)
2. Does the chart of accounts provide adequate control accounts for principal amounts and related interest expenses of debt and other borrowings?
3. Are the detailed records maintained by responsible person(s) whose duties do not include:
  - a. Maintenance of the general ledger control accounts?
  - b. Physical custody of agreements connected with borrowings and unissued debt instruments?
  - c. Cash functions?
4. Do persons who maintain the detail records and control accounts receive timely and adequate information about debt and other borrowing obligations (for example, copies or abstracts of the debt and lease agreements)?
5. Are detailed records reconciled with the control accounts at reasonable intervals by persons whose duties do not include:
  - a. Maintenance of the detailed records on debt and other borrowings?
  - b. Custody of agreements connected with borrowings and unissued debt instruments?
6. Are adequate reports developed from the detailed records and actual debt and lease agreements which provide timely and accurate information as a basis for:
  - a. Payments of principal and interest in conformity with the agreements?

- b. Monitoring compliance with terms and covenants in the agreements?

(See AAM section 4400.280, *Expenditure Cycle*, for illustrative objectives and questions on cash disbursements.)

7. Are detailed records compared with debt and lease agreements at reasonable intervals by responsible persons whose duties do not include:
  - a. Maintenance of the detailed records?
  - b. Custody of the debt and lease agreements?
  - c. Maintenance of the general ledger control accounts?
  - d. Cash functions?
8. If independent agents are retained for the interest paying and redemption functions, are the agents' reports promptly reconciled with the control accounts and subsidiary records?

#### **.450 Safeguarding Records, Documents, and Unissued Debt Instruments**

##### *Objective*

- Access to records, documents, and instruments concerning debt and other borrowing arrangements is permitted only in accordance with management's authorization.

##### *Questions—Control Policies and Procedures*

1. Does a responsible individual maintain adequate files of copies of notes payable, long-term debt, mortgage agreements, and leases?
2. Are unissued debt instruments such as notes and bonds adequately safeguarded and in the custody of a responsible employee whose duties do not include—
  - a. Maintenance of detailed records on borrowings and other term obligations?
  - b. Maintenance of general ledger control accounts?
  - c. Cash functions?
3. Are unissued debt instruments subject to pre-assigned numerical control and are all such instruments accounted for at reasonable intervals?
4. Are paid bonds and notes effectively cancelled to preclude their further use?

#### **C. Equity Capital**

#### **.460 Authorization of Equity Capital Transactions**

##### *Objective*

- Equity capital transactions are—
  - (a) appropriately authorized and approved in conformity with the entity's governing document (corporate charter, partnership agreement, etc.)
  - (b) initiated and executed in accordance with management's authorization.

*Questions—Control Policies and Procedures*

1. Are capital transactions (issuance, reacquisition, and redemption of stock, dividends, granting of options, rights, conversion privileges, etc.) authorized and approved in conformity with the entity's governing document?

(The entity's governing document (corporate charter, partnership agreement, etc.) may clearly specify the groups or designated officials who have authority concerning the initiation and approval of specific types of capital transactions.)

2. Are authorizations and approvals for specific capital transactions appropriately recorded?

(For example, if the corporate charter provides that capital transactions be initiated by the board of directors subject to approval of the stockholders, such authorizations and approvals would be recorded in the respective minutes of board of directors' meetings and stockholders' meetings.)

3. Are two officials specifically authorized by the board of directors required to sign and countersign stock certificates?

4. Are all stock certificates prepared and approved before issuance in accordance with management's authorization?

(Prescribed procedures would include, for example, compliance with tax and other statutory requirements before signing and issuing certificates. For transfers and retirements of certificates, prescribed procedures would include cancellation and disposition of the certificates received.)

5. If a registrar, transfer agent and/or dividend paying agent is retained, have they been authorized by the board of directors?

**.470 Recording and Classifying Equity Capital Transactions***Objective*

- Transactions and obligations concerning equity capital are promptly and accurately recorded and classified in detailed records and control accounts.

*Questions—Control Policies and Procedures*

1. Does the general ledger include appropriate control accounts for equity capital?
2. Are appropriate control records maintained for each class of stock on such information as number of shares authorized, issued and outstanding, and number of shares subject to options, warrants, and conversion privileges?
3. Are timely detailed records maintained on the specific stock certificates issued and outstanding for each class of capital stock and the identity of holders of record and number of shares for each certificate?

(In a closely held corporation with a limited number of shareholders and outstanding certificates, properly completed stubs in capital stock certificate books may serve this purpose. Retired certificates would normally be cancelled and reattached to the related stubs. Other situations may require a data base that permits timely rendering of listings of each certificate by number and/or of each shareholder and number of shares held.)

4. Are detailed stock certificate records reconciled at reasonable intervals with the control records and the general ledger?

(If the corporation retains independent agents for the registrar and transfer functions, for example, the agents' periodic reports would be promptly reconciled with the general ledger.)

5. Are reconciliations of detailed records with the control records and general ledger performed by persons whose duties do not include:
  - a. Custody of unissued stock certificates?
  - b. Maintenance of the detailed records?
  - c. Cash functions?

#### **.480 Physical Safeguards and Custodial Procedures**

##### *Objectives*

- Access to records, agreements, and such negotiable documents as stock certificates concerning equity capital is permitted only in accordance with management's authorization.
- Records, agreements, and negotiable documents are subjected to reasonably adequate physical safeguards and custodial procedures.

##### *Questions—Control Policies and Procedures*

1. Are unissued stock certificates, reacquired certificates and detailed stockholder records subject to reasonable physical safeguards?  
(Examples include fire-resistant files, vaults, and use of safe deposit boxes.)
2. Are stock certificates subject to controls such as pre-numbering which provides that all certificates (unissued, issued, and retired) may be accounted for?
3. Are unissued and retired stock certificates examined and all certificate numbers accounted for at reasonable intervals by a person(s) whose duties do not include:
  - a. Physical custody of unissued stock certificates?
  - b. Maintenance of stockholder detail records?
  - c. Cash functions?
  - d. General ledger functions?
4. Are retired stock certificates—
  - a. Examined for proper endorsement and effectively cancelled by a person(s) whose duties do not include maintenance of the detailed stockholder records?
  - b. Matched and recorded promptly in the detailed records of certificates (reattached to related stubs in the certificate book)?
5. Are treasury stock certificates registered in the name of the company and recorded to be readily distinguished from other outstanding shares?

#### **.490 Dividends Disbursements**

##### *Objective*

- Dividends are disbursed accurately and in conformity with decisions of the board of directors.

##### *Questions—Control Policies and Procedures*

1. Are dividends declared recorded in the minutes of the board of directors meetings regarding class of stock, amount per share, total amount, record date, and payment date?

2. Do procedures result in an accurate cutoff and accurate listing of stockholders as of the record date?
3. Are dividend checks prepared based on appropriate stockholder listings and subjected to the following:
  - a. Approval and signature in accordance with management's authorization.
  - b. Mailing by a person(s) whose duties do not include maintenance of detailed records of stockholders, custody of unissued and retired stock certificates, and check preparation functions?
4. Are total dividends disbursed reconciled to total outstanding shares as of the record date?

#### D. Cash <sup>4</sup>

#### .500 Processing Collections

##### *Objectives*

- Access to cash receipts and cash receipts records, accounts receivable records, and billing and shipping records is controlled to prevent or detect, on a timely basis, the taking of unrecorded cash receipts or the abstraction of recorded cash receipts.
- Detail transaction and account balance records are reconciled, at reasonable intervals, with applicable control accounts and bank statements for timely detection and corrections of errors.

##### *Questions—Control Policies and Procedures*

1. Is the mail opened by a person(s) whose duties do not involve any shipping, billing, accounts receivable detail, general ledger, invoice processing, payroll, and cash disbursement functions?
2. Does the person(s) who opens the mail:
  - a. Place restrictive endorsements on all checks when received so they are for deposit only to the bank accounts of the company?
  - b. List or otherwise obtain control (for example, by photocopying) over all remittances and prepare totals at least daily?
  - c. Forward all remittances to the person who prepares and makes the daily bank deposit?
  - d. Forward the total of remittances to persons, who are independent of physical handling of remittances and accounts receivable detail functions, for subsequent comparison with the authenticated duplicate deposit slip and with control total over postings to subsidiary records?

(In lock box arrangements, customers would mail their remittances to a post office box controlled by the company's bank which would have responsibility for functions 2a-2d.)
3. Are receipts of currency controlled by cash registers and/or pre-numbered cash receipt forms?
  - a. If cash registers are used, is a copy of the tape given to the customer as a receipt, and:
    - (1) Is the key to the cash register tape compartment in the custody at all times of a responsible employee other than the cash register operator(s)?
    - (2) Are readings of the register periodically taken and compared with the cashier's records of receipts by a responsible employee other than the cash register operator(s)?
  - b. If pre-numbered receipts are used for currency collections:

<sup>4</sup> The illustrative internal control structure objectives and related questions for these cash sections are the same as those for the cash receipts sections of the revenue cycle (AAM section 4400.190—200) and cash disbursements sections of the expenditures cycle (AAM section 4400.280—300). They are duplicated here in AAM section 4400.500—.540 because some accountants may prefer to consider them as part of a financing (treasury) cycle.

- (1) Is a copy given to the payor as a receipt?
- (2) Are all prenumbered receipts accounted for by a person(s) other than the person(s) handling cash received and balanced with the daily cash received?
- c. If cash collections are for payments on account, is adequate information given for accurate posting to accounts receivable detail?
- d. If significant cash sales are made (as in a retail store) are spot checks made to determine that cashiers are following prescribed procedures?
4. Are currency receipts forwarded daily to the person who prepares the daily bank deposit?
5. Is a summary listing of daily currency receipts forwarded to a person(s) independent of physical handling of remittances and accounts receivable detail functions?
6. Do areas involving physical handling of cash appear reasonably safeguarded?  
(For example, protective windows, vaults, cashier cages, etc.)
7. Are each day's receipts (by mail, and over the counter) except for postdated items deposited intact daily?
8. Are postdated items segregated on daily detail listings of remittances to aid in control of total items received?
9. Are all employees who handle receipts adequately bonded?
10. Are banks instructed not to cash checks and other instruments (for example, drafts, money orders, etc.) drawn to the order of the company?
11. Does company policy prohibit the cashing of any accommodation checks (for example, personal and payroll checks) out of collections?
12. Are local bank accounts used for branch office collections subject to withdrawal only by the home office?
13. Are banks instructed to deliver charged back deposit items (such as checks returned because of insufficient funds) directly to an employee independent of physical handling of cash receipts and posting of accounts receivable detail?
14. Are bank chargebacks received directly from the bank and investigated by a person independent of:
  - a. Physical handling of collections?
  - b. Posting accounts receivable subsidiary detail?
15. Are entries to the cash receipts journal compared with:
  - a. Duplicate deposit slips authenticated by the bank?
  - b. Deposits per the bank statements?
  - c. Listings prepared (initial control) when mail is opened?
16. Are the comparisons described in item 15 above made by a person(s) whose duties do not include cash receipts and accounts receivable functions?

#### **.510 Recording Collections**

##### *Objective*

- All cash receipts are recorded at the correct amounts in the period in which received, and are properly classified and summarized.

*Questions—Control Policies and Procedures*

1. Is information captured from remittances (by mail and over the counter) adequate for accurate posting of credits to individual accounts receivable subsidiary records or to classifications concerning such other sources as investment income, rents, sales of property or scrap, and proceeds of financing?

(This information, for example, may be included on the listing prepared when the mail is opened, remittance advices which accompany customers' checks, detachable stubs from billings, photocopies of checks, copies of pre-numbered receipts issued for currency collections, etc.)

2. Are details of daily collections balanced with the total credits to be distributed to appropriate general ledger accounts and to the total collections for the day before posting to the subsidiary records?
3. Do postings of the general ledger control accounts and subsidiary records include the date on which the remittance was received?
4. Are postings to the general ledger control accounts made by a person(s) independent of:
  - a. Physical handling of collections?
  - b. Posting accounts receivable subsidiary detail?
5. Are details of collections posted to subsidiary accounts receivable records by a person(s) independent of:
  - a. General ledger functions?
  - b. Physical handling of collections?
  - c. Receipt and investigation of bank chargebacks?

**.520 Assignment of Disbursement Functions***Objective*

- Functions are assigned so that no single individual is in a position to both perpetrate and conceal errors or irregularities in the normal course of his duties.

*Questions—Control Policies and Procedures*

1. Is the cash disbursements function performed by persons who are independent of the following functions:
  - a. Purchasing?
  - b. Receiving?
  - c. Invoice processing?
  - d. Payroll preparation and approval?
  - e. Shipping?
  - f. Accounts receivable?
  - g. Cash receipts?
  - h. General ledger?
2. Is there adequate separation of duties within the cash disbursement function among persons who perform the following:
  - a. Control access to unissued checks?

- b. Prepare checks?
- c. Sign checks and inspect support?
- d. Mail checks?
- e. Maintain custody of petty cash?
- f. Maintain the cash disbursement journal?
- g. Reconcile the bank accounts?

### **.530 Processing Disbursements**

#### *Objectives*

- Disbursements are made only for expenditures incurred in accordance with management's authorization.
- Adjustments to cash accounts are made only in accordance with management's authorization.
- Disbursements are recorded at correct amounts in the appropriate period and are properly classified in the accounts.
- Access to cash and cash disbursements records is restricted to minimize opportunities for irregular or erroneous disbursements.

#### *Questions—Control Policies and Procedures*

1. Are all bank accounts authorized by the board of directors?
2. Are all check signers authorized by the board of directors?
3. Are banks promptly notified of any changes in authorized check signers?
4. Are banks instructed not to cash checks and other instruments (for example, drafts, money orders, etc.) drawn to the order of the company?
5. Are all bank accounts and cash funds subjected to general ledger control?
6. Are all disbursements and bank transfers based on vouchers and check requests which have been approved by responsible employees designated by management?
7. Are all disbursements except from petty cash made by check?
8. Are properly approved supporting documents (processed invoices, purchase orders, receiving reports, etc.) presented with the checks and reviewed by the check signer(s) before signing the checks?
9. Is a mechanical check protector used to inscribe amounts on checks as a precaution against alteration?
10. Are supporting documents for checks properly cancelled to avoid duplicate payment?
11. Are signed checks independently mailed directly after signing without being returned to persons involved in the invoice processing and check preparation functions?
12. Is access to unissued checks limited to designated responsible employees who are independent of the check signing function, including operation of mechanical check signing machines?
13. Are checks pre-numbered and all numbers accounted for?
14. Are all voided checks retained and mutilated?



15. Are all checks promptly recorded when issued and listed in detail (cash disbursements journal, check register, etc.)?
16. Are details of individual disbursements balanced with the totals to be posted to appropriate general ledger account distributions and to total disbursements to be posted to the general ledger control accounts for cash?
17. Is there a written policy which prohibits:
  - a. Drawing checks payable to cash or bearer?
  - b. Signing or countersigning of blank checks?
18. If dual signatures are required:
  - a. Are the two signers independent of one another?
  - b. Does each signer determine that the disbursement is supported by approved documentation?
19. If a check signing machine is used:
  - a. Are checks approved before mechanical signing by designated responsible employees who are subject to the same segregation of duties as if they were authorized check signers?

(Use of a check signing machine allows an entity to delegate authority for approving checks to a greater number of persons than those registered with the bank as authorized signers. However, approval procedures should be sufficient to assure the official whose name is on the signature plate that all mechanically signed checks would have met his approval if he had reviewed and manually signed them himself.)
  - b. Are the keys, signature plate, and operation of the signing machine under control at all times of the official whose signature is on the plate?
  - c. Are the employees who have custody of the keys, plate, and operate the check signing machine independent of voucher and check preparation functions and denied access to blank checks?
  - d. Are the checks issued to the machine operator(s) counted in advance and reconciled with the totals of the counting device on the check signing machine by someone other than the machine operator?

(Control may be strengthened by having a locked compartment on the machine which receives the signed checks and can be opened only by someone independent of the machine operator.)
20. Are cash funds on an imprest basis and:
  - a. Kept in a safe place?
  - b. Reasonable in amount?
  - c. Controlled by one custodian who is independent of invoice processing, check signing, general accounting, and cash receipts functions?
  - d. Periodically counted by someone other than the custodian?
21. Are all disbursements from cash funds:
  - a. Supported by vouchers which are prepared in ink?
  - b. Approved in accordance with management's authorization?
  - c. Cancelled to prevent reuse?

- d. Subject to a predetermined maximum dollar limit for any individual disbursement?
- 22. Are reimbursements of cash funds:
  - a. Subject to the same review and approval as processed invoices?  
(See AAM section 4400.230 on invoice processing)
  - b. Remitted by checks drawn payable to the order of the custodian of the cash fund?

#### **.540 Bank Reconciliations**

##### *Objective*

- Comparison of detail records, control accounts, and bank statements are made at reasonable intervals for detection and appropriate disposition of errors or irregularities.

##### *Questions—Control Policies and Procedures*

1. Are the bank accounts reconciled monthly by an employee(s) who is independent of invoice processing, cash disbursements, cash receipts, petty cash, and general ledger functions?
  2. Are bank statements, related paid checks, debit and credit memos received directly from the bank by the employee(s) performing the reconciliations?
  3. Does the bank reconciliation procedure include:
    - a. Reconciliation of the balance per bank to balance per the general ledger control account and subsidiary detail records?
    - b. Comparison in detail of deposits per the bank statement with deposits per cash receipts detail records?
    - c. Comparisons in detail of disbursements per bank with the cash disbursements journal (check register) as to date drawn, payee, and amount?
    - d. Comparison of payees with endorsements?
    - e. Follow up of reconciling items and initiation of entries to record such transactions as checks returned for insufficient funds and bank charges?
  4. Are old outstanding checks investigated and subjected to proper disposition (in compliance with applicable escheat laws if present)?
- 

[The next page is 4501.]



# AAM Section 4500

## *Flowcharts*

.01 A flowchart is a diagram which uses symbols to portray the flow of transactions and the various steps applied in that process.

.02 Use of flowcharts is widespread among persons involved in computerized information processing. Some auditors also use flowcharts as their preferred method of documenting their understandings of their clients' internal control structure. Some firms, as an internal policy, urge their staff auditors to use flowcharting. Other firms require use of flowcharting on audits of clients over a given level of size or complexity.

.03 The decision to use flowcharts rests with the individual firm or auditor. Proponents of flowcharting believe the auditor can more easily read and analyze a flowchart than a narrative description of a structure, especially when reviewing understandings which are developed by assistants. They also believe the discipline needed to prepare flowcharts encourages staff to obtain a clearer, more accurate understanding of the structure being documented, particularly the control points in the structure. Those with reservations about flowcharting are concerned that the potential benefits of flowcharting are not enough to justify the time and effort needed to prepare them. They also are concerned that staff may get lost in excessive detail or stray into extraneous areas. A decision to use flowcharts, therefore, implies a concurrent decision to develop adequate instructional material.

### **Types of Flowcharts**

.04 Some users of flowcharts classify them into the following three types:

- Systems flowchart—provides a broad overview of a system.
- Program flowchart—concerned with the minute steps of a system, generally a computer program. Some users also describe computer program flowcharts as block diagrams.
- Internal control structure flowchart—portrays the interaction of departments and/or individuals involved in the plan of organization and the procedures and records concerned with the safeguarding of assets and the reliability of financial records.

Some data processing people who tend to confront complex situations develop sets of charts in several layers with each layer oriented towards a different level of users; this is termed a hierarchical approach.

### **Degree of Detail**

.05 The question of how much detail an auditor should include in a flowchart is a difficult one. And the answer is elusive; it varies with the professional judgment of the auditor who has final responsibility for the engagement. A related difficult matter is how to help assistants avoid the pitfalls of including excess and/or extraneous detail in their flowcharts and the accompanying run-up of time. In deciding on an appropriate policy, the auditor should recognize that his working papers, taken as a whole, should be adequate to document his understanding of the client's internal control structure and help support his assessments of control risk.

### **Flowcharting Illustration—Small Business**

.06 Use of flowcharts need not be limited to recording an understanding of complex information processing systems. An illustration is included below to show how an auditor might use flowcharts to record an understanding of purchases, receipt of stock, and cash disbursements for purchases for Kilroy Wholesale Grocery. John Kilroy owns and operates the business with two employees. One employee serves as both the stock clerk and truck driver. The other employee is the bookkeeper.

.07 A symbol legend is also included to explain the five different symbols used in the illustrative flowcharts. In practice, an auditor would probably use a standard set of flowchart symbols which would eliminate the need for preparing flowchart symbol legends for each set of working papers. The symbols used in the illustrative flowcharts are from the set of standard flowcharting symbols developed by the American National Standards Institute, Inc. (ANSI) which is sponsored by the Business Equipment Manufacturers Association.<sup>1</sup> Some accounting firms have developed or adopted other sets of symbols to meet their individual needs.

.08 The following illustrative transaction processing flowcharts of Kilroy Wholesale Grocery are presented as:

- Purchases and Receipts of Stock (paragraphs .11—.12)
- Cash Disbursements for Purchases (paragraphs .13—.14)

.09 There are also various approaches to the layout of flowcharts. For example, the illustrations present the functions of more than one person (or department) on each sheet. An alternate approach would be to limit a page or set of pages to the functions of a single department or individual. In addition, the illustrative flowcharts present vertical flow lines that start at the top of the page. An alternate approach would be to present horizontal flow lines that start at the left side of the page. These alternate approaches depend on the preferences of the individual firm or the auditor who has final responsibility for the engagement.

---

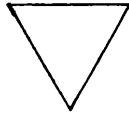
<sup>1</sup> ANSI, American National Standard Flow Chart Symbols and Their Usage in Information Processing. (1430 Broadway, New York, N.Y. 10018) 1971.

.10

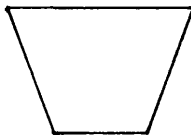
Kilroy Wholesale Grocery  
Symbol Legend - Transaction Processing  
Flowcharts



= Document



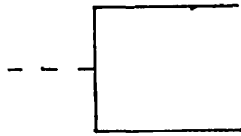
= File



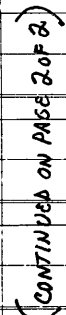
= Manual operations. This symbol represents a process or work step performed by a person.



= Connector symbol. Used as a cross reference within a page or between pages.

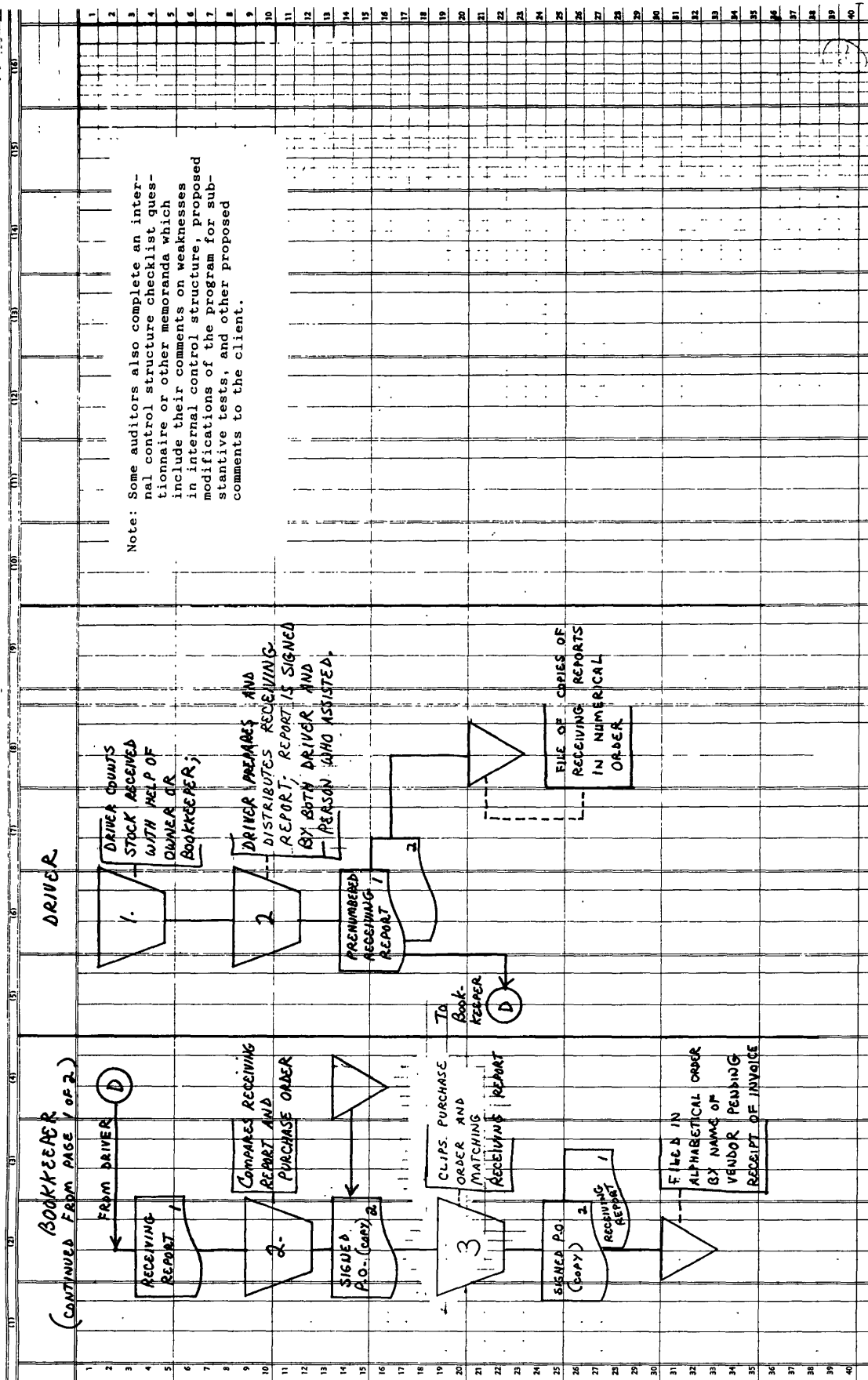


= Comment or annotations symbol. This symbol is used to present comment or additional explanation which would not be able to fit within other symbols.



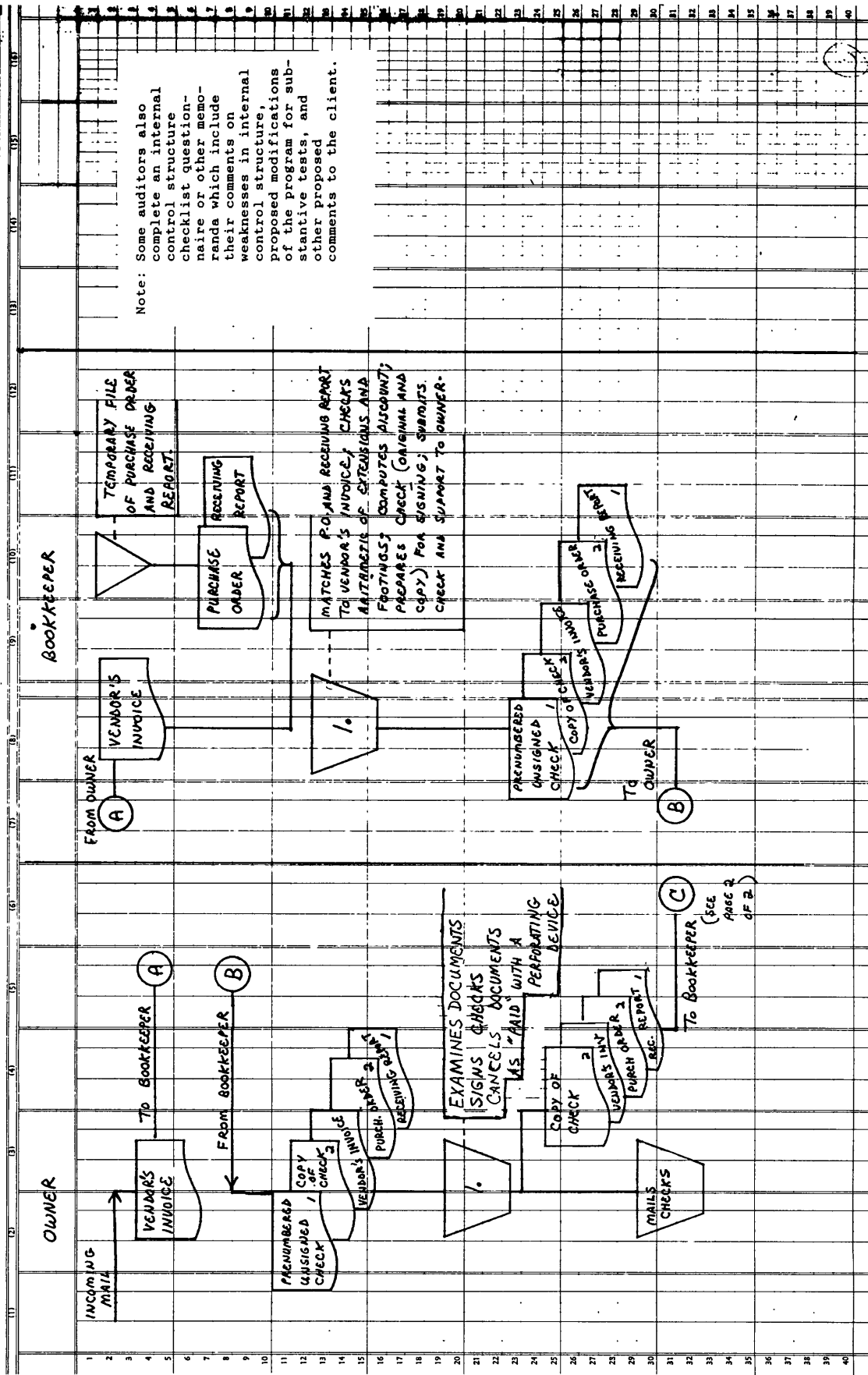
12 KILROY WHOLESALE GROCERY  
PURCHASES AND RECEIPT OF STOCK, PAGE 2 OF 2  
TRANSACTION PROCESSING FLOW CHART

Prepared By	Date
Approved By	



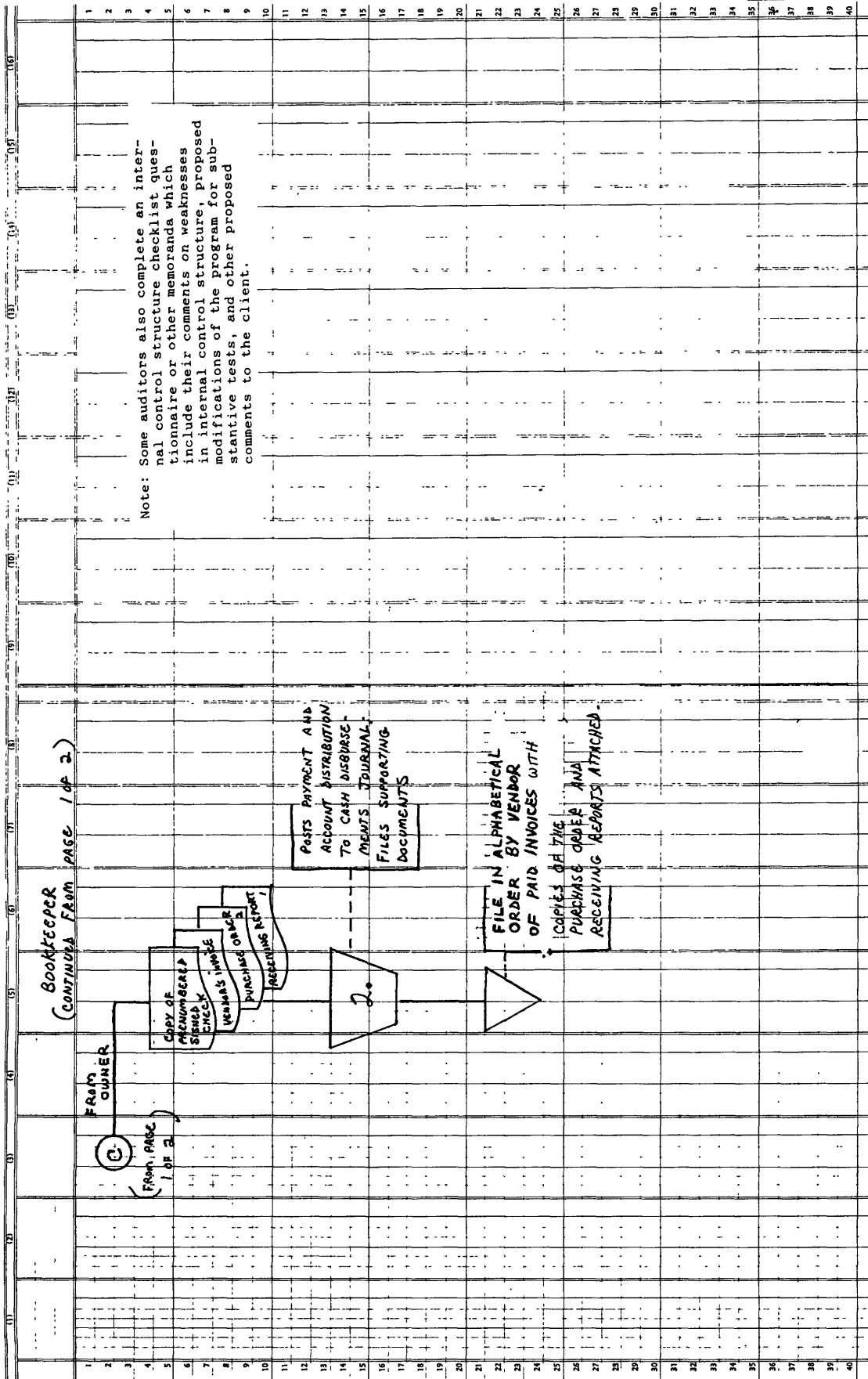


13 KILROY WHOLESALE GROCERY  
CASH DISBURSEMENTS FOR PURCHASES, PAGE 1 OF 2  
TRANSACTION PROCESSING FLOW CHART



14 KILROY WHOLESALE GROCERY  
CASH DISBURSEMENTS FOR PURCHASES, PAGE 2 OF 2  
TRANSACTION PROCESSING: FLOW CHART

Prepared By: ABC 11/1/78  
Approved: DOE 11/5/78



[The next page is 4601.]



## **AAM Section 4600**

### ***Illustrative Internal Control Structure Questions—State and Local Governmental Units***

.010 The following is a list of illustrative internal control structure questions an auditor might raise concerning a state or local governmental unit. The extent of internal control structure policies and procedures that an organization should establish is a judgment that must be made by the management of the entity. The judgment is affected by circumstances, such as the size of the organization and the number of personnel available, and by conclusions about the relationship of costs and benefits. These illustrative questions are numbered merely for organization purposes. The numbers are in no way intended to infer completeness or a preferred sequence. A firm that believes the questionnaire approach is appropriate for its practice should develop its own internal control structure questionnaires based on its own needs and preferences. In any event, users of checklists and questionnaires should recognize that important matters in a particular set of circumstances may not be covered in a standard checklist.

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
<b>I. Control Environment *</b>			
<b>.020 A. Budgets and Planning</b>			
<b>Segregation of Duties</b>			
1. Are responsibilities for budget preparation, adoption, execution, and reporting segregated?	_____	_____	_____
<b>Procedural Controls</b>			
<b>Preparation</b>			
2. Does the law require an awareness of budgets and budgetary procedures?	_____	_____	_____
3. Are budgets prepared for all significant activities regardless of whether mandated by law?	_____	_____	_____
4. Is a budget calendar used for the orderly submission and approval of the budget?	_____	_____	_____
5. Have initial budget submissions been developed and prepared by major departments and activity centers?	_____	_____	_____
6. Has a finance or budget officer reviewed departmental budgets and have the departments of oversight or integration of the executive's goals and objectives made corrections?	_____	_____	_____
7. Is the type of budgeting performed (traditional, program, performance) compatible with the accounting system?	_____	_____	_____
8. Is the budget prepared in sufficient detail (responsibility level) providing a meaningful tool with which to monitor subsequent performance?	_____	_____	_____
9. Are interfund and interdepartmental transfers included in the budget?	_____	_____	_____
<b>Adoption</b>			
10. Is citizen input obtained through budget hearings?	_____	_____	_____
11. Has the budget been, submitted to the legislative body for approval and is there clear communication to operation departments or agencies of the effects of legislatively mandated budget modifications, either increases or decreases?	_____	_____	_____
12. Coincident with adoption of the budget, has there been appropriate legislative action to—			
● Adopt legislation to implement the raising of budgeted revenues?	_____	_____	_____
● Initiate expenditure appropriations?	_____	_____	_____
13. Are estimated revenues and appropriations recorded in the accounting records for later comparison to actual amounts realized or incurred?	_____	_____	_____
14. Are budgets that have been approved by grantors in connection with grant activity recorded in the accounting system?	_____	_____	_____
15. Are budgets published if required by law?	_____	_____	_____
<b>Execution</b>			
16. Have procedures been adopted and communicated establishing authority and responsibility for transfers between budget categories?	_____	_____	_____
17. Is the flow of expenditures or commitments controlled through the use of an allotment system?	_____	_____	_____
18. Does the accounting department submit approval as to availability of funds before the issuance of a purchase order or expenditure commitment?	_____	_____	_____
19. Are requests for supplemental appropriations or budget changes processed and approved in the same manner as the original budget is processed and approved (or as required by law)?	_____	_____	_____
20. If liabilities and expenditures are recorded on an encumbrance or obligation basis, are there controls to ensure knowledge of outstanding commitments?	_____	_____	_____

\* The control environment questions in AAM section 4600.020—.040 specifically apply to governmental entities and are not intended to be all inclusive. The auditor should also consider the illustrative control environment inquiries in AAM section 4400.050—.110, which may apply to governmental entities.

	Yes	No	N/A
<b>Reporting</b>			
21. Are actual expenditures compared to budget with reasonable (monthly) frequency and on a timely basis?	___	___	___
22. Are reports discussed with departmental personnel and are there explanations for significant variations from budget?	___	___	___
23. Are executive and legislative branches notified of expenditures in excess of appropriations or budget?	___	___	___
24. Are actual results of operations against the budget published if required by law?	___	___	___
<b>.030 B. Conflict of Interest Requirements</b>			
1. Does a formal policy regarding conflicts of interest exist?	___	___	___
2. Are written representations required from appropriate personnel as to compliance with accounting policies and procedures and ethics policies?	___	___	___
3. Are loans to officials and employees prohibited or closely controlled?	___	___	___
<b>.040 C. Monitoring of Control Policies and Procedures</b>			
1. Are the adequacy and effectiveness of the internal control structure policies and procedures relevant to the entity's transaction classes (revenues and receivables, procurement, etc.) and account balances periodically evaluated?	___	___	___
2. Are measures implemented to correct weaknesses?	___	___	___
<b>II. Accounting System</b>			
<b>.050 A. General</b>			
1. Does the entity have adequate written statements and explanations of its accounting policies and procedures?	___	___	___
(Written accounting policies and procedures may include such matters as:			
(i) Chart of accounts accompanied by explanations of the items to be included in the various accounts.			
(ii) Identification and description of the principal accounting records, recurring standard entries, and requirements for supporting documentation. For example, this may include information about the general ledger, source journals, subsidiary ledgers, and detail records for each significant class of transactions.			
(iii) Expression of the assignment of responsibilities and delegation of authority including identification of the individuals or positions that have authority to approve various types of recurring and non-recurring entries.			
(iv) Explanations of documentation and approval requirements for various types of recurring and non-recurring transactions and journal entries. Documentation requirements, for example, would include the basis and supporting computations required for adjustments and write-offs.			
(v) Instructions for determining an adequate cutoff and closing of accounts for each reporting period.)			
2. Are accounting policy and procedure manuals updated as necessary?	___	___	___
3. Are manuals distributed to appropriate personnel?	___	___	___
4. Do procedures exist to ensure that only authorized persons can alter or establish a new accounting principle, policy, or procedure to be used by the entity?	___	___	___
5. Does the principal accounting officer of the entity have adequate authority over accounting employees and principal accounting records at all locations?	___	___	___
6. Are the principal accounting, treasury, and custody functions segregated?	___	___	___
7. Are the responsibilities for maintaining the general ledger segregated from those for maintaining subsidiary ledgers?	___	___	___
8. Are the responsibilities for maintaining the general ledger and custody of assets segregated?	___	___	___
9. Is access to the general ledger and related records restricted to those who are assigned general ledger responsibilities?	___	___	___
10. Are there adequate facilities for custody of the general ledger and related records? (Examples of such facilities include fire-resistant locked cabinets, vaults, physical barriers, separate rooms, limited access to work areas, alarms, and other detection devices.)	___	___	___

	Yes	No	N/A
11. Is appropriate insurance coverage maintained in amounts required by statutes or entity policy? (Such insurance may include loss of records coverage and fidelity bonding of employees in positions of trust.)	_____	_____	_____
12. Are the preparation and approval functions for journal entries segregated?	_____	_____	_____
13. Are all journal entries reviewed and approved by designated individuals at appropriate levels in the entity? (The levels at which journal entries are reviewed and approved will usually vary depending on whether the entries are recurring, or non-recurring, routine or unusual, accumulations of routine transactions, or adjustments of balances requiring estimates and judgments.)	_____	_____	_____
14. Are all journal entries adequately explained and supported? (Explanation and support for an entry should be sufficient to enable the person responsible for its review and approval to reasonably perform this function.)	_____	_____	_____
15. Do all journal entries include approval in accordance with management's general or specific authorization?	_____	_____	_____
16. Are all journal entries subject to controls over completeness of processing? (Examples of controls over completeness of processing include pre-numbering of journal vouchers and accounting for all numbers used, accumulation of control totals of dollar amounts debited and credited, and standard identification numbers for recurring entries.)	_____	_____	_____
17. Do all journal entries include adequate identification of the accounts in which they are to be recorded?	_____	_____	_____

**.060 B. Electronic Data Processing****Segregation of Duties**

- |   |       |       |       |
|---|-------|-------|-------|
| 1. Is the EDP department independent from the accounting and operating departments for which it processes data?   | _____ | _____ | _____ |
| 2. Does appropriate segregation of duties exist within the data processing function for (a) systems development (design and programming), (b) technical support (maintenance of systems software), and (c) operations?                              | _____ | _____ | _____ |
| 3. In smaller and minicomputer installations with limited opportunities for segregation of duties, do procedures exist for user departments to—   |       |       |       |
| ● Utilize batch or other input controls?  | _____ | _____ | _____ |
| ● Control master file changes?  | _____ | _____ | _____ |
| ● Balance master files between processing cycles?   | _____ | _____ | _____ |
| 4. Do the personnel policies of the EDP function include such procedures as reference checks, security statements, rotation of duties, and terminated employee security measures that enhance segregation of duties and otherwise improve controls? | _____ | _____ | _____ |

**Procedural Controls****User Controls**

- |   |       |       |       |
|---|-------|-------|-------|
| 5. Do controls exist over preparation and approval of input transactions outside the EDP department and is the department prohibited from initiating transactions?  | _____ | _____ | _____ |
| 6. Does the user exercise control procedures over input to ensure that all approved input is processed correctly through the system and only once?  | _____ | _____ | _____ |
| 7. Do controls exist over entry of data in on-line systems to restrict access to terminals and data entry to authorized employees?  | _____ | _____ | _____ |
| 8. Do on-line systems controls exist that prevent documents from being keyed into the system more than once and that permit tracing from computer output to data source and vice versa?   | _____ | _____ | _____ |
| 9. Do controls exist over changes to master files, such as requiring preparation of specific forms indicating data to be changed, approval by a supervisor in the user department, and verifying against a printout of changes? | _____ | _____ | _____ |
| 10. Do user controls exist over rejected transactions through the use of a computerized suspense file of rejected transactions or an auxiliary manual system?   | _____ | _____ | _____ |

	Yes	No	N/A
11. Does user department management reconcile output totals to input totals for all data submitted, reconcile the overall file balances, and review outputs for reasonableness?	_____	_____	_____
<b>Application Controls</b>			
12. Do procedures exist within the data processing control function that provide that data is properly controlled between the user and the EDP department?	_____	_____	_____
13. Do controls exist over data entry, for example, that include adequate supervision, up-to-date instructions, key verification of important fields, and self-checking digits?	_____	_____	_____
14. Do program controls exist over entry of data into on-line systems?	_____	_____	_____
15. Is input data edited and validated?	_____	_____	_____
16. Do data processing controls exist over rejected transactions?	_____	_____	_____
17. Do controls exist for balancing transactions and master files?	_____	_____	_____
18. Do procedures exist within the data processing control function concerning review and distribution of output?	_____	_____	_____
<b>General Controls</b>			
19. Do controls exist over changes to system software?	_____	_____	_____
20. Do controls exist over use and retention of tape and disk files, including provisions for retention of adequate records to provide backup capabilities?	_____	_____	_____
21. Do controls exist that limit access to data processing equipment, tapes, disks, system documentation, and application program documentation to authorized employees?	_____	_____	_____
22. Is a job accounting system (or console logs) used to ensure that scheduled programs are processed and proper procedures followed and that supervisory personnel know that only required programs have been processed?	_____	_____	_____
23. Are EDP department employees supervised for all shifts?	_____	_____	_____
24. Are procedures to be followed by computer operators documented?	_____	_____	_____
25. Is the data processing system documented such that the organization could continue to operate if important data processing employees leave?	_____	_____	_____
26. Do procedures exist to protect against a loss of important files, programs, or equipment?	_____	_____	_____
27. Are equipment, programs, and data files covered by insurance?	_____	_____	_____
28. Are there user-approved written specifications for new systems and modifications to existing application systems?	_____	_____	_____
29. Are there written procedures to test and implement new systems and modifications to existing application systems?	_____	_____	_____
<b>.070 C. Financial Reporting</b>			
<b>Segregation of Duties</b>			
1. Is the final review and approval of financial reports segregated from the responsibility for preparation of the reports?	_____	_____	_____
<b>Procedural Controls</b>			
<b>General Ledger</b>			
2. Is there a formal plan of organization for the unit of government under which reporting responsibilities are clearly defined and reasonably aligned?	_____	_____	_____
3. Is the principal accounting officer over accounting records and accounting employees supervised at all locations?	_____	_____	_____
4. Is there general ledger control over all assets and transactions of all departments of the organization?	_____	_____	_____
<b>Closing</b>			
5. Are procedures and policies for closing the accounts for a reporting period sufficient to ensure that accounts are closed, adjusted, and reviewed on a timely basis?	_____	_____	_____
6. Do procedures exist to ensure that all accounting systems have included all transactions applicable to the reporting period?	_____	_____	_____



	Yes	No	N/A
7. Are valuation reserves or other account balances based on estimates reviewed and approved?	_____	_____	_____
8. Are all journal entries reviewed, approved, and supported by adequate descriptions or documentation?	_____	_____	_____
9. Do controls exist that ensure that only authorized individuals can initiate entries?	_____	_____	_____
<b>Combining</b>			
10. Do procedures exist to ensure the orderly and effective accumulation of financial data?	_____	_____	_____
11. Do procedures exist for the orderly processing of financial data received from departments and other accounting units?	_____	_____	_____
12. Do procedures exist to permit the recording and review of special entries generated in the combining process?	_____	_____	_____
<b>Preparation, Review and Approval</b>			
13. Do procedures exist to ensure that financial reports are supported by either underlying account records or other documentation?	_____	_____	_____
14. Do procedures exist providing reasonable assurances that all data required to be included in legal as well as public reports are properly disclosed?	_____	_____	_____
15. Do procedures exist to ensure that financial reports are prepared on a consistent basis?	_____	_____	_____
16. Are financial reports reviewed and approved at appropriate levels of management and, if appropriate, by the legislature before public release?	_____	_____	_____
17. Are there procedures to ensure that all requirements for filing of financial reports are met (for example, senior levels of government, bondholders, and the public)?	_____	_____	_____
<b>.080 D. Identified Significant Account Balances and Transaction Classes</b>			
1. Cash?	_____	_____	_____
2. Investments?	_____	_____	_____
3. Revenues and Receivables?	_____	_____	_____
4. Capital Assets?	_____	_____	_____
5. Procurement and Payables?	_____	_____	_____
6. Employee Compensation?	_____	_____	_____
<b>III. Cash</b>			
<b>.090 A. Segregation of Duties</b>			
1. Are responsibilities for collection and deposit preparation functions segregated from those for recording cash receipts and general ledger entries?	_____	_____	_____
2. Are responsibilities for cash receipts functions segregated from those for cash disbursements?	_____	_____	_____
3. Are responsibilities for disbursement preparation and disbursement approval functions segregated from those for recording or entering cash disbursements information on the general ledger?	_____	_____	_____
4. Are responsibilities for the disbursement approval function segregated from those for the disbursement, voucher preparation, and purchasing functions?	_____	_____	_____
5. Are responsibilities for entries in the cash receipt and disbursement records segregated from those for general ledger entries?	_____	_____	_____
6. Are responsibilities for preparing and approving bank account reconciliations segregated from those for other cash receipt or disbursement functions?	_____	_____	_____
7. If EDP is used, is the principle of segregation of duties within processing activities maintained?	_____	_____	_____
<b>.100 B. Procedural Controls</b>			
<b>Collections</b>			
8. Are all receipts deposited on a timely basis (preferably daily)?	_____	_____	_____
9. Do controls exist over the collection, timely deposit, and recording of collections in the accounting records in each collection location?	_____	_____	_____
10. Is the general accounting department notified on a timely basis of cash receipts from separate collection locations?	_____	_____	_____

	Yes	No	N/A
11. Are daily reported receipts compared on a test basis to bank statements to verify timeliness of deposits?	_____	_____	_____
12. Is a restrictive endorsement placed on each incoming check upon receipt?	_____	_____	_____
13. Are "not sufficient funds" checks delivered to someone independent of processing and recording of cash receipts?	_____	_____	_____
14. Do procedures exist for follow-up of "not sufficient funds" checks?	_____	_____	_____
15. Do controls exist to ensure that checks are returned promptly for deposit if checks received are forwarded to be used as posting media to taxpayers' or customers' accounts?	_____	_____	_____
16. Are receipts controlled by cash register, pre-numbered receipts, or other equivalent means if payments are made in person (over the counter)?	_____	_____	_____
17. Are receipts accounted for and balanced to collections on a daily basis?	_____	_____	_____
18. Do facilities exist for protecting undeposited cash receipts?	_____	_____	_____
<i>Disbursements</i>			
19. Does control exist over warrant or check-signing machines as to signature plates and usage?	_____	_____	_____
20. Are procedures provided for immediate notification to banks when warrant or check signers leave the unit or are otherwise no longer authorized to sign?	_____	_____	_____
21. Are invoices and supporting documents furnished to the signer prior to signing the warrant or check?	_____	_____	_____
22. Are reasonable limits set on amounts that can be paid by facsimile signatures?	_____	_____	_____
23. Are two signatures required on warrants or checks over a stated amount?	_____	_____	_____
24. Are signature plates maintained in the custody of the person whose facsimile signature is on the plate when not in use?	_____	_____	_____
25. Are signature plates under the signer's control when in use?	_____	_____	_____
26. Is the recording machine read by the signer or an appropriate designee to ascertain that all checks or warrants signed are properly accounted for by comparison to document control totals?	_____	_____	_____
27. Are signed warrants or checks delivered directly to the mailroom making them inaccessible to persons who requested, prepared, or recorded them?	_____	_____	_____
28. Is the drawing of warrants or checks to cash or bearer prohibited?	_____	_____	_____
<i>Custody</i>			
29. Are controls maintained over the supply of unused and voided warrants or checks?	_____	_____	_____
30. Are bank accounts properly authorized?	_____	_____	_____
31. Are depositories periodically reviewed and formally reauthorized?	_____	_____	_____
32. Do controls and physical safeguards exist surrounding working (petty cash) funds?	_____	_____	_____
33. Is adequate fidelity insurance maintained?	_____	_____	_____
34. Are separate bank accounts maintained for each fund, or if not, is there adequate fund control over pooled cash?	_____	_____	_____
<i>Detail Accounting</i>			
35. Do procedures exist to ensure that collections and disbursements are recorded accurately and promptly?	_____	_____	_____
36. Do procedures exist for authorizing and recording interbank and interfund transfers and for providing for proper accounting for those transactions?	_____	_____	_____
<i>General Ledger</i>			
37. Does general ledger control exist over all bank accounts?	_____	_____	_____
38. Are bank statements and paid warrants or checks delivered in unopened envelopes directly to the employee preparing the reconciliation?	_____	_____	_____
39. Do procedures exist for steps essential to an effective reconciliation, particularly—			
● Comparison of warrants or checks in appropriate detail with disbursement records?	_____	_____	_____
● Examination of signature and endorsements, at least on a test basis?	_____	_____	_____
● Accounting for numerical sequence of warrants or checks used?	_____	_____	_____

	Yes	No	N/A
● Comparison of book balances used in reconciliations with general ledger accounts?	_____	_____	_____
● Comparison of deposit amounts and dates with cash receipt entries?	_____	_____	_____
● Footing of cash books?	_____	_____	_____
40. Are all reconciliations and investigations of unusual reconciling items reviewed and approved by an official who is not responsible for receipts and disbursements, including recording evidence of the review and approval by signing the reconciliation?	_____	_____	_____
41. Are checks outstanding for a considerable time periodically reviewed for propriety?	_____	_____	_____

#### IV. Investments

##### .110 A. Segregation of Duties

- |  |       |       |       |
|--|-------|-------|-------|
| 1. Are responsibilities for initiating, evaluating, and approving transactions segregated from those for detail accounting, general ledger, and other related functions? | _____ | _____ | _____ |
| 2. Are responsibilities for initiating transactions segregated from those for final approvals that commit government resources?  | _____ | _____ | _____ |
| 3. Are responsibilities for monitoring investment market values and performance segregated from those for investment acquisition?  | _____ | _____ | _____ |
| 4. Are responsibilities for maintaining detail accounting records segregated from those for general ledger entries?  | _____ | _____ | _____ |
| 5. Are custodial responsibilities for securities or other documents evidencing ownership or other rights assigned to an official who has no accounting duties?           | _____ | _____ | _____ |
| 6. If EDP is used, is the principle of segregation of duties within processing activities maintained?  | _____ | _____ | _____ |

##### .120 B. Procedural Controls

###### *Approval*

- |   |       |       |       |
|---|-------|-------|-------|
| 7. If applicable, are procedures adequate to ensure that only investments that are permitted by law are acquired?                               | _____ | _____ | _____ |
| 8. Are investment policy guidelines formally established and periodically reviewed?   | _____ | _____ | _____ |
| 9. Is the investment program integrated with the cash management program and expenditure requirements?  | _____ | _____ | _____ |
| 10. Have authority and responsibility been established for investment opportunity evaluation and purchase?                                      | _____ | _____ | _____ |
| 11. Is the performance of the investment portfolio periodically evaluated by persons independent of investment portfolio management activities? | _____ | _____ | _____ |
| 12. Are procedures formally established governing the level and nature of approvals required to purchase or sell an investment?                 | _____ | _____ | _____ |
| 13. Are competitive bids sought for certificate of deposit purchases?   | _____ | _____ | _____ |

###### *Custody*

- |  |       |       |       |
|--|-------|-------|-------|
| 14. Do adequate physical safeguards and custodial procedures exist over—   |       |       |       |
| ● Negotiable and nonnegotiable securities owned?   | _____ | _____ | _____ |
| ● Legal documents or agreements evidencing ownership or other rights?  | _____ | _____ | _____ |
| 15. Are dual signatures or authorizations required to obtain release of securities from safekeeping or to obtain access to the government unit's safe deposit box? | _____ | _____ | _____ |
| 16. Are persons with access to securities authorized by the legislative body?  | _____ | _____ | _____ |
| 17. Are all securities registered in the name of the government unit?  | _____ | _____ | _____ |
| 18. Are securities periodically inspected or confirmed from safekeeping agents?  | _____ | _____ | _____ |
| 19. Are individuals with access to securities bonded?  | _____ | _____ | _____ |

###### *Detail Accounting*

- |   |       |       |       |
|---|-------|-------|-------|
| 20. Are detail accounting records maintained for investments?   | _____ | _____ | _____ |
| 21. Do procedures exist to ensure that transactions arising from investments are properly processed, including income and amortization entries? | _____ | _____ | _____ |

	Yes	No	N/A
22. Do controls exist to ensure that investment earnings are credited to the fund from which resources were provided for the investment?	_____	_____	_____
23. Are periodic comparisons made between income received and the amount specified by the terms of the security or publicly available investment information?	_____	_____	_____
24. Do controls exist to ensure that transactions are recorded on a timely basis?	_____	_____	_____
<b>General Ledger</b>			
25. Do procedures exist for reconciling the detail accounting records with the general ledger control?	_____	_____	_____
26. Is the nature of investments included in general ledger balances periodically reviewed?	_____	_____	_____

## V. Revenues and Receivables

### .130 A. Segregation of Duties

- |  |       |       |       |
|--|-------|-------|-------|
| 1. Are the responsibilities for billing property taxes and services segregated from collection and accounting?                         | _____ | _____ | _____ |
| 2. Are the responsibilities for maintaining detail accounts receivable records segregated from collections and general ledger posting? | _____ | _____ | _____ |
| 3. Are the collection, control, and deposit of funds activities segregated from the accounting records maintenance function?           | _____ | _____ | _____ |
| 4. Are property tax assessment rolls maintained by individuals not engaged in any accounting or collection function?                   | _____ | _____ | _____ |
| 5. Are responsibilities for entries in the cash receipts records segregated from those for general ledger entries?                     | _____ | _____ | _____ |
| 6. If EDP is used, is the principle of segregation of duties within processing activities maintained?                                  | _____ | _____ | _____ |

### .140 B. Procedural Controls

#### **Data and File Maintenance**

##### *Property taxes*

- |  |       |       |       |
|--|-------|-------|-------|
| 7. Do controls exist to ensure that additions, deletions, transfers, and abatements are properly and timely reflected in property tax records? | _____ | _____ | _____ |
| 8. Do procedures exist to make property assessments in accordance with the law or legislative intent with prompt adjustment of records?        | _____ | _____ | _____ |

##### *Sales, income, and other taxes*

- |  |       |       |       |
|--|-------|-------|-------|
| 9. Are filed returns cross-referenced against a data base of previous taxpayers?   | _____ | _____ | _____ |
| 10. Are records organized and integrated in such a fashion that probable taxpayers are identified as a result of reporting of other governmental activities such as licensing? | _____ | _____ | _____ |

##### *License fees and permits*

- |   |       |       |       |
|---|-------|-------|-------|
| 11. If annual payments are involved, do procedures exist to ensure that previous years' records are properly updated for new registrants and withdrawals? | _____ | _____ | _____ |
| 12. Are updated records used as the basis for billing persons subject to payment?   | _____ | _____ | _____ |

##### *Fines, forfeitures, and court fees*

- |   |       |       |       |
|---|-------|-------|-------|
| 13. Are court and other records of payments due maintained and used as a basis for collections?   | _____ | _____ | _____ |
| 14. Do procedures exist surrounding the control, issuance, and disposition of traffic violations to ensure that amounts due are assessed and collected? | _____ | _____ | _____ |

##### *Enterprise and other service revenues*

- |  |       |       |       |
|--|-------|-------|-------|
| 15. Are controls maintained that provide assurances that customer data base and, where appropriate, usage records are accurately maintained to ensure that amounts due are billed? | _____ | _____ | _____ |
|--|-------|-------|-------|

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
<b><i>Billing/Remittance Verification</i></b>			
<i>Property taxes</i>			
16. Do controls exist within the billing system to ensure that eligible property owners are billed?	_____	_____	_____
17. Do controls exist to ensure that tax assessments are being properly applied against tax rates and special charges are being considered in the preparation of billing amounts?	_____	_____	_____
18. Do controls exist to ensure that tax exemptions are within the law and properly approved?	_____	_____	_____
<i>Sales, income, and other taxes</i>			
19. Are returns reviewed for mathematical accuracy?	_____	_____	_____
20. Are current year's taxpayers' returns correlated with prior year's returns and are differences reviewed and accounted for?	_____	_____	_____
21. Are claims for refunds reviewed and approved separately?	_____	_____	_____
22. Are audits of returns filed to provide reasonable assurance that taxable income is properly reported?	_____	_____	_____
<i>License fees and permits</i>			
23. Are current year receipts compared to those for prior years and are explanations of variations reviewed by senior officials?	_____	_____	_____
<i>Fines, forfeitures, and court fees</i>			
24. Do procedures exist providing for correlation of amounts collected with records of court proceedings?	_____	_____	_____
25. Are tickets for fines, arrests, and so forth sequentially numbered and satisfactorily accounted for?	_____	_____	_____
<i>Enterprise and other service revenues</i>			
26. If billing is based on usage, are service readings performed in a timely fashion?	_____	_____	_____
27. Are assignments of meter readers periodically rotated?	_____	_____	_____
28. Do billing procedures exist providing for identification and investigation of unusual patterns of use?	_____	_____	_____
<b><i>General</i></b>			
29. Are taxes and fees billed in a timely fashion?	_____	_____	_____
30. Do procedures exist designed for other revenue areas ensuring timely payment of amounts due?	_____	_____	_____
31. Are rates of taxes, fines, fees, and services periodically reviewed and approved by the legislative body?	_____	_____	_____
32. Are programs of tax exemption or relief periodically reviewed and approved by the legislative body?	_____	_____	_____
33. Are utility rate schedules authorized by the legislative body?	_____	_____	_____
34. Do procedures exist providing for timely notification of the accounting department at the time tax, service, or other billings or claims are prepared and rendered?	_____	_____	_____
35. Do numerical or batch-processing controls exist over tax, fee, service, or other billings?	_____	_____	_____
36. Do controls exist over the billing of miscellaneous revenues (for example, sidewalk replacement and tree removal assessments)?	_____	_____	_____
37. Do procedures exist to prevent the interception or alteration by unauthorized persons of billings or statements after preparation but before they are mailed?	_____	_____	_____
38. Does an individual independent of receivables record keeping promptly investigate disputes with billing amounts that are reported by taxpayers or service recipients?	_____	_____	_____
39. Do controls exist providing reasonable assurances that restricted revenues are expended only for restricted purposes?	_____	_____	_____
<b><i>Collection</i></b>			
40. Is restrictive endorsement placed on incoming checks as soon as received?	_____	_____	_____
41. Do procedures exist providing reasonable assurances that interest and penalties are properly charged on delinquent taxes, fees, or charges for service?	_____	_____	_____

	Yes	No	N/A
42. Do procedures exist providing for the timely filing of liens on property for nonpayment in all cases permitted by law?	_____	_____	_____
43. Do controls exist surrounding the collection, timely deposit, and recording of collections in the accounting records at each collection location?	_____	_____	_____
44. Is the general accounting department notified of cash receipts from separate collection centers on a timely basis?	_____	_____	_____
45. If payments are made in person, are receipts for payment used and accounted for and balanced to collections?	_____	_____	_____
46. Are amounts collected on behalf of other governments segregated and remitted on a timely basis?	_____	_____	_____
47. Are taxes and fees collected by another unit of government monitored to assure timely receipt and are amounts received subjected to reviews for reasonableness?	_____	_____	_____
48. Are delinquent accounts reviewed and considered for charge-off on a timely basis?	_____	_____	_____
49. Are write-offs or other reductions of receivables formally approved by senior officials not involved in the collection function?	_____	_____	_____
50. Do procedures exist providing for execution of all legal remedies to collect charged-off or uncollectible accounts, including tax sale of property, liens, and so forth?	_____	_____	_____
<b>Accounts Receivable Record Keeping</b>			
51. Do controls in the system exist that provide assurances that individual receivable records are posted only from authorized source documents?	_____	_____	_____
52. Are aggregate collections on accounts receivable reconciled against postings to individual receivable accounts?	_____	_____	_____
53. Are statements of account balance mailed on a timely basis, where appropriate (for example, in proprietary funds)?	_____	_____	_____
<b>General Ledger</b>			
54. Are trial balances of individual receivable accounts prepared on a timely basis?	_____	_____	_____
55. Are trial balances reconciled with general ledger control accounts and are reconciling items investigated by someone other than accounts receivable clerks?	_____	_____	_____
56. Are aged accounts receivable balances periodically reviewed by supervisory personnel?	_____	_____	_____
57. Do procedures exist providing for timely and direct notification of the accounting department of billings and collection activities?	_____	_____	_____
<b>Grant and Entitlement Monitoring</b>			
<b>Grants</b>			
58. Is responsibility for monitoring grant activities properly fixed?	_____	_____	_____
59. Is grant activity monitored from a centralized location?	_____	_____	_____
60. Do procedures exist to monitor compliance with—			
● Financial reporting requirements?	_____	_____	_____
● Use of funds and other conditions in accordance with grant terms?	_____	_____	_____
● Timely billing of amounts due under grants?	_____	_____	_____
61. Is grant activity accounted for so that it can be separated from the accounting for locally funded activities?	_____	_____	_____
62. Is there a system for obtaining grantor approval before incurring expenditures in excess of budgeted amounts or for unbudgeted expenditures?	_____	_____	_____
63. Are grant revenues and disbursements processed under the same degree of controls applicable to the organization's other transactions (budget, procurement, etc.)?	_____	_____	_____
64. Are requirements included in subgrantee agreements that the subgrantee comply with the primary grant agreement conditions as well as the grantee's standards?	_____	_____	_____
65. Do reasonable procedures and controls exist to provide assurances of compliance with recipient eligibility requirements established by grants?	_____	_____	_____
66. Is an indirect cost allocation plan established?	_____	_____	_____
67. Is the plan approved by all grantor agencies?	_____	_____	_____
68. Is audit cognizance established for rates generated by the plan?	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
<i>Entitlements</i>			
69. Is the amount of funds received compared with the amount anticipated by a responsible official and are unusual variances investigated?	___	___	___
70. Do procedures exist to ensure that funds received are spent in accordance with legal requirements and spending restrictions?	___	___	___
71. Are statistical or data reports that form the basis for revenue distribution reviewed by a responsible official before submission?	___	___	___

## VI. Capital Assets

### .150 A. Segregation of Duties

- Are responsibilities for initiating, evaluating, and approving capital expenditures, leases, and maintenance or repair projects segregated from those for project accounting, property records, and general ledger functions?
- Are responsibilities for initiating capital asset transactions segregated from those for final approvals that commit government resources?
- Are responsibilities for the project accounting and property records functions segregated from the general ledger function?
- Are responsibilities for the project accounting and property records functions segregated from the custodial function?
- Are responsibilities for the periodic physical inventories of capital assets assigned to responsible officials who have no custodial or record keeping responsibilities?
- If EDP is used, is the principle of segregation of duties maintained within processing activities?

___	___	___
___	___	___
___	___	___
___	___	___
___	___	___
___	___	___

### .160 B. Procedural Controls

#### *Authorization*

- Are those individuals authorized to initiate capital asset transactions identified and is there clear definition of the limits of their authority?
- Are guidelines established with respect to key considerations such as prices to be paid, acceptable vendors and terms, asset quality standards, and the provisions of grants or bonds that may finance the expenditures?
- Is a separate capital projects budget prepared?

___	___	___
___	___	___
___	___	___

#### *Executive or Legislative Approval*

- Is written executive or legislative approval required for all significant capital asset projects or acquisitions?
- Do procedures exist for authorizing, approving, and documenting sales or other dispositions of capital assets?
- Do procedures exist for approving decisions regarding financing alternatives and accounting principles, practices, and methods?
- Do procedures exist providing for obtaining grantor (federal/state) approval, if required, for the use of grant funds for capital asset acquisitions?
- Are grant-funded acquisitions subjected to the same controls as internally funded acquisitions?
- Are supplemental authorizations required, including, if appropriate, those of the grantor agency, for expenditures in excess of originally approved amounts?

___	___	___
___	___	___
___	___	___
___	___	___
___	___	___
___	___	___

#### *Project Accounting*

- Is a qualified employee or independent firm engaged to inspect and monitor technically complex projects?
- Are project cost records established and maintained for capital expenditure and repair projects?
- Do reporting procedures exist for in-progress and completed projects?
- Do procedures exist to identify completed projects so that timely transfers to the appropriate accounts can be made?
- Is the accounting distribution reviewed to ensure proper allocation of charges to fixed asset and expenditure projects?

___	___	___
___	___	___
___	___	___
___	___	___
___	___	___

	Yes	No	N/A
21. If construction work is performed by contractors, do procedures exist to provide for and maintain control over construction projects and progress billings?	_____	_____	_____
22. Does the unit of government have the right to audit contractors' records?	_____	_____	_____
23. Is the right to audit contractor records during project performance exercised?	_____	_____	_____
24. Do audits of contractors cover compliance with EEO, Davis Bacon, and other regulations and contract terms, in addition to costs?	_____	_____	_____
<b>Asset Accountability</b>			
25. Are detail property records maintained for all significant self-constructed, donated, purchased, or leased assets?	_____	_____	_____
26. Is the accountability for each asset established?	_____	_____	_____
27. Do procedures exist for periodic inventory of documents evidencing property rights (for example, deeds, leases, and the like)?	_____	_____	_____
28. Do physical safeguards over assets exist?	_____	_____	_____
29. Do procedures exist ensuring that purchased materials and services for capital expenditure and repair projects are subjected to the same levels of controls as exist for all other procurements (for example, receiving, approval, checking)?	_____	_____	_____
30. Are detailed property records periodically compared with existing assets?	_____	_____	_____
31. Are differences between records and physical counts investigated and are the records adjusted to reflect shortages?	_____	_____	_____
32. Do procedures exist ensuring that capital assets are adequately insured?	_____	_____	_____
33. Are lease transactions subjected to control procedures similar to those required for other capital expenditures?	_____	_____	_____
34. Is equipment properly identified by metal numbered tags or other means of positive identification?	_____	_____	_____
35. Are fully depreciated assets carried in the accounting records as a means of providing accounting control?	_____	_____	_____
36. Do procedures exist for monitoring the appropriate disposition of property acquired with grant funds?	_____	_____	_____
<b>General Ledger</b>			
37. Are detailed property records periodically reconciled with the general ledger control accounts?	_____	_____	_____
38. Do procedures and policies exist to—			
● Distinguish between capital projects' fund expenditures and operating budget expenditures?	_____	_____	_____
● Identify operating budget expenditures to be capitalized in the fixed asset fund?	_____	_____	_____
● Distinguish between capital and operating leases?	_____	_____	_____
● Govern depreciation methods and practices?	_____	_____	_____
39. If costs are expected to be charged against federal grants, are depreciation policies or methods of computing allowances in accord with the standards outlined in OMB circulars or grantor agency regulations; if not, is depreciation charged to grants adjusted accordingly?	_____	_____	_____
40. Are the accounting records adjusted promptly—both the asset and related allowance for depreciation—when items of plant and equipment are retired, sold, or transferred?	_____	_____	_____

## VII. Procurement and Payables

### 170 A. Segregation of Duties

- |   |       |       |       |
|---|-------|-------|-------|
| 1. Are responsibilities for the requisitioning, purchasing, and receiving functions segregated from the invoice processing, accounts payable, and general ledger functions? | _____ | _____ | _____ |
| 2. Are responsibilities for the purchasing function segregated from the requisitioning and receiving functions?   | _____ | _____ | _____ |
| 3. Are responsibilities for the invoice processing and accounts payable functions segregated from the general ledger functions?   | _____ | _____ | _____ |



	Yes	No	N/A
4. Are responsibilities for the disbursement preparation and disbursement approval functions segregated from those for recording cash disbursements and general ledger entries?	_____	_____	_____
5. Are responsibilities for the disbursement approval function segregated from those for the disbursement preparation function?	_____	_____	_____
6. Are responsibilities for entries in the cash disbursement records segregated from those for general ledger entries?	_____	_____	_____
7. If EDP is used, is the principle of segregation of duties maintained within processing activities?	_____	_____	_____
<b>.180 B. Procedural Controls</b>			
<b><i>Requisitioning</i></b>			
8. Are purchases of goods and services initiated by properly authorized requisitions bearing the approval of officials designated to authorize requisitions?	_____	_____	_____
9. Are requisitions pre-numbered and are those numbers controlled?	_____	_____	_____
10. Is the appropriation to be charged indicated on the purchase requisition by the person requesting the purchase?	_____	_____	_____
11. Before commitment, are unobligated funds remaining under the appropriation verified by the accounting or budget department as sufficient to meet the proposed expenditure?	_____	_____	_____
12. Are requests for special purpose (nonshelf items) materials or personal services accompanied by technical specifications?	_____	_____	_____
<b><i>Purchasing</i></b>			
13. Are purchasing authorizations structured to give appropriate recognition to the nature and size of purchases and the experience of purchasing personnel?	_____	_____	_____
14. Do approval procedures exist for purchase order and contract issuance?	_____	_____	_____
15. Are purchase prices periodically reviewed by a responsible employee independent of the purchasing department?	_____	_____	_____
16. Are competitive bidding procedures used?	_____	_____	_____
17. If practicable, are contract or purchasing officer's areas of responsibility rotated on a regular basis?	_____	_____	_____
18. Do provisions in contracts for materials, services, or facilities acquired on other than a fixed price basis provide for an audit of contractors' costs, with payments subject to audit results?	_____	_____	_____
19. Do procedures exist for public advertisement of nonshelf item procurements in accordance with legal requirements?	_____	_____	_____
20. Are recurring purchases and documentation of the justification for informal rather than competitive bids periodically reviewed?	_____	_____	_____
21. Are policies regarding conflicts of interest and business practice policies established, documented, and distributed?	_____	_____	_____
22. Are purchase orders and contracts issued under numerical or some other suitable control?	_____	_____	_____
23. Are an adequate number of price quotations obtained before placing orders not subject to competitive bidding?	_____	_____	_____
24. Is splitting orders prohibited to avoid higher levels of approval?	_____	_____	_____
25. Are price lists and other appropriate records of price quotations maintained by the purchasing department?	_____	_____	_____
26. Is a record of suppliers who have not met quality or other performance standards by the purchasing department maintained?	_____	_____	_____
27. Are procedures modified when funds disbursed under grant or loan agreements and related regulations impose requirements that differ from the organization's normal policies?	_____	_____	_____
28. Are procedures instituted to identify, before order entry, costs and expenditures not allowable under grant (federal/state) programs?	_____	_____	_____
29. Is an adequate record of open purchase orders and agreements maintained?	_____	_____	_____
30. Are purchases made for the accommodation of employees prohibited or adequately controlled?	_____	_____	_____

	Yes	No	N/A
31. If construction contracts are to be awarded, are bid and performance bonds considered?	_____	_____	_____
32. Does predetermining selection criteria exist for awarding personal service or construction contracts and is adequate documentation of the award process required?	_____	_____	_____
33. Are changes to contracts or purchase orders subjected to the same controls and approvals as the original agreement?	_____	_____	_____
<b>Receiving</b>			
34. Are receiving reports prepared for all purchased goods?	_____	_____	_____
35. Do procedures exist for the filing of claims against carriers or vendors for shortages or damaged materials?	_____	_____	_____
36. Are steps taken to ensure that goods received are accurately counted and examined to see that they meet quality standards?	_____	_____	_____
37. Is a permanent record of material received by the receiving department maintained?	_____	_____	_____
38. Are receiving reports numerically accounted for or otherwise controlled to ensure that all receipts are reported to the accounting department?	_____	_____	_____
39. Are copies of receiving reports sent directly to purchasing, accounting, and, if appropriate, inventory record keeping?	_____	_____	_____
40. Is a government technical representative assigned to monitor and evaluate contractor performance and approve receipt of services with respect to procurements of special purpose materials, services, or facilities?	_____	_____	_____
41. If a receiving department is not used, do adequate procedures exist to ensure that goods for which payment is made have been received and are verified by someone other than the individual approving payment that goods have been received and meet quality standards?	_____	_____	_____
<b>Invoice Processing</b>			
42. Do invoice processing procedures provide for—			
● Obtainment directly from issuing departments of copies of purchase orders and receiving reports?	_____	_____	_____
● Comparison of invoice quantities, prices, and terms with those indicated on the purchase order?	_____	_____	_____
● Comparison of invoice quantities with those indicated on the receiving reports?	_____	_____	_____
● As appropriate, checking accuracy of calculations?	_____	_____	_____
43. Are all invoices received from vendors in a central location, such as the accounting department?	_____	_____	_____
44. Do procedures exist ensuring that the accounts payable system is properly accounting for unmatched receiving reports and invoices?	_____	_____	_____
45. Are requests for progress payments under long-term contracts related to contractors' efforts and are they formally approved?	_____	_____	_____
46. Do procedures exist for processing invoices not involving materials or supplies (for example, lease or rental payments, utility bills)?	_____	_____	_____
47. Do procedures exist ensuring accurate account distribution of all entries resulting from invoice processing?	_____	_____	_____
48. If applicable, is access to the EDP master vendor file limited to employees authorized to make changes?	_____	_____	_____
49. Does the accounting department maintain a current list of those authorized to approve expenditures?	_____	_____	_____
50. Do procedures exist for submission and approval of reimbursement to employees for travel and other expenses?	_____	_____	_____
51. Is control established by the accounting department over invoices received before releasing them for departmental approval and other processing?	_____	_____	_____
52. Is the distribution of charges in the accounting department reviewed by a person competent to pass on the propriety of the distribution?	_____	_____	_____
53. Are invoices (vouchers) reviewed and approved for completeness of supporting documents and required clerical checking by a senior employee?	_____	_____	_____

	Yes	No	N/A
54. If an invoice is received from a supplier not previously dealt with, are steps taken to ascertain that the supplier actually exists?	_____	_____	_____
55. Are payments made only on the basis of original invoices?	_____	_____	_____
56. Is responsibility fixed for seeing that all cash discounts are taken and, if applicable, that exemptions from sales, federal excise, and other taxes are claimed?	_____	_____	_____
57. Are differences in invoice and purchase order price, terms, shipping arrangements, or quantities referred to purchasing for review and approval?	_____	_____	_____
58. Does the accounting department record and follow up partial deliveries?	_____	_____	_____
59. Are the accounting and purchasing departments promptly notified of returned purchases, and are such purchases correlated with vendor credit advices?	_____	_____	_____
60. Is the program and expenditure account to be charged reviewed for propriety and budget conformity?	_____	_____	_____
61. Do check signers or other responsible officials determine that restricted revenues are expended only for restricted purposes?	_____	_____	_____
62. If applicable, do procedures exist to ensure adjustment of the reserve for encumbrances (obligations) when invoices are prepared for payment?	_____	_____	_____
<b>Disbursements</b>			
63. Do procedures exist for disbursement approval and warrant or check-signing?	_____	_____	_____
64. Is there control over warrant or check-signing machines as to signature plates and usage?	_____	_____	_____
65. Do procedures exist to notify banks when a new signer is authorized or a previous signer leaves the employ of the government?	_____	_____	_____
66. Is the signer furnished with invoices and supporting data and are they reviewed prior to signing the warrant or check?	_____	_____	_____
67. Are reasonable limits set on amounts that can be paid by facsimile signatures?	_____	_____	_____
68. Are two signatures required on all warrants or checks over a stated amount?	_____	_____	_____
69. Are signature plates maintained in the custody of the person whose facsimile signature is on the plate when not in use?	_____	_____	_____
70. Are plates only under the signer's control used and does that person or an appropriate designee record machine readings to ascertain that all checks or warrants signed are properly accounted for?	_____	_____	_____
71. Are invoices and supporting documents cancelled by or in the presence of the signer at the time of signing?	_____	_____	_____
72. Are signed warrants or checks delivered directly to the mail room, making them inaccessible to persons who requested, prepared, or recorded them?	_____	_____	_____
73. Are warrants or checks cross-referenced to vouchers?	_____	_____	_____
74. Are warrants or checks controlled and accounted for with safeguards over those unused and voided?	_____	_____	_____
75. Is the drawing of warrants or checks to cash or bearer prohibited?	_____	_____	_____
76. Do procedures exist ensuring that warrants or checks that have been signed and issued are recorded promptly?	_____	_____	_____
<b>Accounts Payable Encumbrances or Obligations</b>			
77. Are statements from vendors compared on a regular basis with recorded amounts payable?	_____	_____	_____
78. If an encumbrance (obligation) system is used, are outstanding purchase orders reconciled to the reserve for encumbrances (obligations) on a monthly basis?	_____	_____	_____
79. Are encumbrance (obligation) entries recorded only on the basis of approved purchase orders?	_____	_____	_____
80. Do procedures exist ensuring that accounts payable and encumbrances (obligations) are applied against the appropriate account?	_____	_____	_____
81. Do procedures exist ensuring that department heads are notified of payments made against accounts payable and encumbrances (obligations)?	_____	_____	_____
<b>General Ledger</b>			
82. Are trial balances of reserve for encumbrances (obligations) and accounts payable prepared on a regular basis?	_____	_____	_____

	Yes	No	N/A
83. Are trial balances footings checked and traced to the individual items as well as comparing the total to the general ledger balance by an employee other than the accounts payable clerk?	_____	_____	_____
84. Are transactions between funds in all affected funds posted in the same accounting period and on a timely basis?	_____	_____	_____
<b>Grant and Entitlement Monitoring</b>			
85. Are grants disbursed only on the basis of approved applications?	_____	_____	_____
86. Are reporting and compliance requirements defined (for example, in regulations) and communicated to grantees?	_____	_____	_____
87. Do procedures exist to monitor grantee compliance with grant terms?	_____	_____	_____
88. Are financial operations of grantees subjected to periodic and timely audit?	_____	_____	_____
89. Are recipients monitored sufficiently and on a timely basis to permit curtailment of any abuse before complete funds disbursement?	_____	_____	_____
90. Are funds disbursed to grantees only on an as-needed basis?	_____	_____	_____
91. Does the level of grant approval authority appear appropriate?	_____	_____	_____
92. Is failure by grantees to meet financial reporting requirements investigated on a timely basis?	_____	_____	_____
93. Are grantees required to evidence correction of previously detected deficiencies before approval of an extension or renewal of a grant?	_____	_____	_____
94. Do entitlement procedures exist ensuring that statistics or data used to allocate funds are accurately accumulated (for example, census bureau forms)?	_____	_____	_____
95. Are statements of recipient compliance required with entitlement conditions (for example, statement of assurances) to be filed and does a responsible official review them?	_____	_____	_____
96. Are audited financial statements or other compliance requirements of entitlement recipients reviewed on a timely basis and are unusual items investigated?	_____	_____	_____

## VIII. Employee Compensation

### .190 A. Segregation of Duties

1. Are responsibilities for supervision and timekeeping functions segregated from personnel, payroll processing, disbursement, and general ledger functions?	_____	_____	_____
2. Are responsibilities for the payroll processing function segregated from the general ledger function?	_____	_____	_____
3. Is payroll distribution supervised by employees—			
● Who are not responsible for hiring or firing employees?	_____	_____	_____
● Who do not approve time reports?	_____	_____	_____
● Who take no part in payroll preparation?	_____	_____	_____
4. Are responsibilities for initiating payments under employee benefit plans segregated from accounting and general ledger functions?	_____	_____	_____
5. Is the payroll bank account reconciled regularly by employees independent of all other payroll transaction processing activities?	_____	_____	_____
6. If EDP is used, is the principle of segregation of duties maintained in processing activities?	_____	_____	_____

### .200 B. Procedural Controls

#### Personnel

7. Are all changes in employment (additions and terminations), salary and wage rates, and payroll deductions properly authorized, approved, and documented?	_____	_____	_____
8. Are notices of additions, separations, and changes in salaries, wages, and deductions promptly reported to the payroll-processing function?	_____	_____	_____
9. Are appropriate payroll records maintained for accumulated employee benefits (vacation, pension data, etc.)?	_____	_____	_____
10. Are terminating employees interviewed as a check on departure and as a final review of any termination settlement by the personnel department?	_____	_____	_____
11. Do written personnel policies exist?	_____	_____	_____

	Yes	No	N/A
12. Are controls established to ensure that payroll costs charged to grants are in compliance with grant agreements?	_____	_____	_____
13. Are payroll and personnel policies governing compensation in accordance with the requirements of grant agreements?	_____	_____	_____
14. Are wages at or above the federal minimum wage?	_____	_____	_____
<b><i>Supervision/Timekeeping</i></b>			
15. Are hours worked, overtime hours, and other special benefits reviewed and approved by the employee's supervisor?	_____	_____	_____
16. Do records and procedures exist for timekeeping and attendance?	_____	_____	_____
17. Are time cards or other time reports reviewed for completeness and approved by the employee's supervisor?	_____	_____	_____
18. If time cards are used, are they punched only by the employees to whom they are issued?	_____	_____	_____
19. Is the time clock placed in a position where it can be observed by a supervisor?	_____	_____	_____
20. Do procedures exist for authorizing, approving, and recording vacations, holidays, and sick leave and is compensatory time controlled and approved?	_____	_____	_____
<b><i>Payroll Processing</i></b>			
21. Do controls exist over payroll preparation?	_____	_____	_____
22. Are changes to the EDP master payroll file approved and documented?	_____	_____	_____
23. Is access to the EDP master payroll file limited to employees who are authorized to make changes?	_____	_____	_____
24. Are completed payroll registers reviewed and approved before disbursements are made?	_____	_____	_____
25. Are documents supporting employee benefit payments (such as accumulated vacation or sick leave) reviewed before disbursements are made?	_____	_____	_____
26. Are comparisons (reconciliations) of gross pay of current to prior period payrolls reviewed for reasonableness by a knowledgeable person not otherwise involved in payroll processing?	_____	_____	_____
27. Is the payroll (examination of authorizations for changes noted on reconciliations) reviewed by an employee not involved in its preparation?	_____	_____	_____
28. Is the distribution of dollars and hours of gross pay balanced with the payroll registers, and reviewed by someone independent but knowledgeable in this area?	_____	_____	_____
29. Is a comparison to amounts appropriated and budgeted included in the review?	_____	_____	_____
30. Are payroll advances to officials and employees prohibited or are they subjected to appropriate review?	_____	_____	_____
<b><i>Disbursement</i></b>			
31. Are signature plates and the use of the payroll check-signing machines kept under control of the official whose name appears on the signature plate or an employee to whom he has delegated that responsibility?	_____	_____	_____
32. Is a log maintained that reconciles the counter on the check-signing machine with the number of checks issued in each payroll?	_____	_____	_____
33. Is a separate, imprest-basis, payroll bank account maintained?	_____	_____	_____
34. Is the payroll bank account reconciled on a regular basis?	_____	_____	_____
35. Are payroll check endorsements compared, on a test basis, with signatures on file by someone independent of the payroll department?	_____	_____	_____
36. Is someone independent of the payroll department comparing payments made in cash, which require signed receipts, with signatures on file on a test basis?	_____	_____	_____
37. Is the supply of unused payroll checks controlled?	_____	_____	_____
38. Are employees required to provide identification before being given checks or pay envelopes?	_____	_____	_____
39. Are employees prohibited from accepting another employee's pay?	_____	_____	_____
40. Are unclaimed wages returned to a custodian independent of the payroll department?	_____	_____	_____
41. Do employees who distribute checks or pay envelopes make a report of unclaimed wages directly to the accounting department?	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
42. Are payments of unclaimed wages made at a later date only upon presentation of appropriate evidence of employment and are they approved by an officer or employee who is not responsible for payroll preparation or time reporting?	_____	_____	_____
43. Are W-2 forms compared to payroll records and mailed by employees not otherwise involved in the payroll process?	_____	_____	_____
44. Do procedures exist for investigating returned W-2s?	_____	_____	_____
45. Are payroll checks periodically distributed by the internal auditors to ascertain that employees exist for all checks prepared?	_____	_____	_____
<b>General Ledger</b>			
46. Do adequate account coding procedures exist for classification of employee compensation and benefit costs so that such costs are recorded in the proper general ledger account?	_____	_____	_____
47. Are accrued liabilities for unpaid employee compensation and benefit costs properly recorded or disclosed?	_____	_____	_____

---

[The next page is 4701.]



# AAM Section 4700

## *The Auditor's Assessment of Control Risk*

.01 Most of the auditor's work in forming an opinion on financial statements consists of obtaining and evaluating evidential matter concerning the assertions in such financial statements. SAS No. 31, *Evidential Matter*, (AU section 326), presents assertions as representations by management that are embodied in financial statement components. In obtaining evidential matter in support of financial statement assertions, the auditor develops specific audit objectives in light of those assertions. There is not necessarily a one to one relationship between audit objectives and audit procedures.

.02 Assertions are classified in SAS No. 31, according to the following broad categories:

- Existence or Occurrence. Reported assets and liabilities actually exist at the balance sheet date, and transactions reported in the income statement actually occurred during the period covered.
- Completeness. All transactions and accounts that should be included in the financial statements are included, and there are no undisclosed assets, liabilities or transactions.
- Rights and Obligations. The entity owns and has clear title to assets and liabilities are the obligations of the entity.
- Valuation or Allocation. The assets and liabilities are valued properly and the revenues and expenses are measured properly.
- Presentation and Disclosure. The assets, liabilities, revenues, and expenses are properly classified, described, and disclosed in the financial statements.

.03 SAS No. 55, *Consideration of the Internal Control Structure in a Financial Statement Audit* (AU section 319), states that the auditor should assess control risk in terms of assertions for material components of the financial statements. Many practitioners may consider audit objectives that relate to the assertions when assessing control risk. SAS No. 55 does not preclude or require any specific approach as long as control risk is ultimately assessed at the assertion level. For example, an approach of identifying internal control structure policies and procedures and relating those to significant audit objectives for account balances or transaction classes would be appropriate. Practice aids for documenting the assessed level of control risk using this approach are illustrated in AAM section 4700.05—4700.09.

.04 The following workpapers for documenting control risk assessments would be prepared only for assertions with an assessed level of control risk below maximum. Based on the results of tests of controls, the auditor determines whether the initial assessment of control risk is appropriate. During planned tests of controls, the auditor may obtain additional evidence and perform additional tests of controls. The results of such tests may support a further reduction in the assessed level of control risk. Conversely, planned tests of controls may indicate that control policies and procedures are ineffective in design or operation. Such results may lead the auditor to assess control risk at maximum for the assertions affected.



.05

ABC Company

Assessment of Control Risk -

12/31/X5

Date	Prepared By	Work Paper No
	Reviewed By	

1				2				3				4			
Transaction Class or Account Balance:				Financial Statement											
				Existence				Completeness				Rights/			
Revenues				Occurrence								Obligations			
1	Relevant Internal Control														
2	Structure Policies/Procedures:														
3															
4	1)	Use of prenumbered shipping													
5		documents												N/A	
6															
7	2)	Shipping documents matched with													
8		prenumbered invoices												N/A	
9															
10	3)	EDP Functions segregated from													
11		users												N/A	
12															
13	4)	Sales and accounts receivable													
14		postings are reconciled												N/A	
15															
16	5)	Billing function segregated from													
17		collection function												N/A	
18															
19	6)	Recording of sales journal and													
20		subsidiary ledger segregated												N/A	
21															
22	7)	Monthly statements sent to													
23		customers												N/A	
24															
25	8)	Invoices are reviewed and verified												N/A	
26															
27															
28															
29															
30															
31															
32															
33															
34															
35															
36															
37															
38	Initial Assessment of Control Risk													N/A	
39	Tests of Controls - W/P Ref.														
40	Final Assessment of Control Risk														

5		6		7		8		9		10	
Assertions											
Valuation		Presentation/									
Allocation		Disclosure									

.06

ABC Company

## Assessment of Control Risk

12/31/X5

Date	Prepared By	Work Paper No.
	Reviewed By	

Transaction Class or Account Balance:		Financial Statement		
Cash Receipts		Existence/ Occurrence	Completeness	Rights/ Obligations
1	Relevant ICS Policies and Procedures:			
2				
3	1) Handling of cash and record			
4	keeping are segregated	✓	✓	N/A
5				
6	2) Use of prenumbered remittance			
7	advices or listings	N/A	✓	N/A
8				
9	3) Independent verification of			
10	recording receipts	N/A	✓	N/A
11				
12	4) Daily recording of receipts	N/A	✓	N/A
13				
14	5) Bank accounts are reconciled			
15	monthly	✓	✓	✓
16				
17				
18				
19				
20				
21				
22				
23				
24				
25				
26				
27				
28				
29				
30				
31				
32				
33				
34				
35				
36				
37				
38	Initial Assessment of Control Risk	Moderate	Low	Low
39	Tests of Controls - W/P Ref.			
40	Final Assessment			

5		6		7		8		9		10	
Assertions											
Valuation		Presentation/									
Allocation		Disclosure									
											1
											2
											3
	✓		✓								4
											5
											6
	✓		✓								7
											8
			N/A								9
	✓										10
			N/A								11
	✓		✓								12
											13
											14
	✓		✓								15
											16
											17
											18
											19
											20
											21
											22
											23
											24
											25
											26
											27
											28
											29
											30
											31
											32
											33
											34
											35
											36
											37
	Low		Moderate								38
											39
											40

.07

ABC Company

Assessment of Control risk

12/31/X5

Date	Prepared By	Work Paper No.
	Reviewed By	

Transaction Class or Account Balance:		Financial Statement		
Purchases		Existence/ Occurrence	Completeness	Rights/ Obligations
1	Relevant ICS Policies and Procedures			
2				
3	1) Use of purchase requisitions,			
4	purchase orders, receiving			
5	reports and matching with			
6	vendor invoices	✓	N/A	✓
7				
8	2) Cancellation of used documents	✓	N/A	N/A
9				
10	3) Use of prenumbered documents	N/A	✓	N/A
11				
12	4) Calculations and amounts are			
13	verified	N/A	N/A	N/A
14				
15	5) Purchases recorded on timely basis	N/A		N/A
16				
17	6) Use of voucher register, or			
18	subsidiary ledger	✓	✓	✓
19				
20	7) Segregation of purchasing,			
21	cash disbursement and recording			
22	functions	N/A	N/A	N/A
23				
24	8) Monthly reconciliation of			
25	subsidiary ledgers to control			
26	accounts	N/A	✓	N/A
27				
28				
29				
30				
31				
32				
33				
34				
35				
36				
37				
38	Initial Assessment of Control Risk	Moderate	Moderate	High
39	Tests of Controls - W/P Ref.			
40	Final Assessment			

5		6		7		8		9		10		
Assertions												
Valuation	Allocation	Presentation/	Disclosure									
												1
												2
												3
												4
												5
N/A		N/A										6
												7
N/A		N/A										8
												9
N/A		N/A										10
												11
												12
✓		N/A										13
												14
N/A		✓										15
												16
												17
✓		✓										18
												19
												20
												21
✓		✓										22
												23
												24
												25
✓		✓										26
												27
												28
												29
												30
												31
												32
												33
												34
												35
												36
												37
Low		Low										38
												39
												40

.08

ABC Company

Assessment of Control Risk  
12/31/X5

Date	Prepared By	Work Paper No.
	Reviewed By	

Transaction Class or Account Balance:		1	2	3	4
			Financial	Statement	
Cash Disbursements			Existence/ Occurrence	Completeness	Rights/ Obligations
1	Relevant ICS Policies and Procedures				
2					
3	1) Supporting documentation required				
4	for payments		✓	N/A	N/A
5					
6	2) Custody of checks and accounts payable				
7	record keeping are segregated		✓	N/A	N/A
8					
9	3) Use of prenumbered checks;				
10	Checks accounted for		N/A	✓	N/A
11					
12	4) Cash accounts reconciled monthly		N/A	✓	N/A
13					
14	5) Supporting documents are verified		N/A	N/A	N/A
15					
16	6) Subsidiary A/P ledgers reconciled				
17	monthly to control account		N/A	N/A	N/A
18					
19					
20					
21					
22					
23					
24					
25					
26					
27					
28					
29					
30					
31					
32					
33					
34					
35					
36					
37					
38	Initial Assessment of Control Risk		Moderate	Moderate	N/A
39	Tests of Controls - W/P Ref.				
40	Final Assessment				

5		6		7		8		9		10		
Assertions												
Valuation	Presentation/											
Allocation	Disclosure											
												1
												2
												3
												4
												5
												6
												7
												8
												9
												10
												11
												12
												13
												14
												15
												16
												17
												18
												19
												20
												21
												22
												23
												24
												25
												26
												27
												28
												29
												30
												31
												32
												33
												34
												35
												36
												37
												38
												39
												40



.09

ABC Company

Assessment of Control Risk

12/31/X5

Date	Prepared By	Work Paper No.
	Reviewed By	

Transaction Class or Account Balance:		Financial Statement	
Payroll		Existence/ Occurrence	Completeness
Relevant ICS Policies and Procedures			Rights/ Obligations
1)	Time cards or documents are approved by appropriate personnel	✓	N/A
2)	Segregation of timekeeping, personnel and payroll functions	✓	N/A
3)	Use of prenumbered payroll checks; Checks accounted for	N/A	✓
4)	Payroll checking account reconciled monthly	N/A	✓
5)	Review and verification of payroll calculations	N/A	✓
6)	Payroll recorded on timely basis	N/A	✓
Initial Assessment of Control Risk		Moderate	Low
Test of Controls - W/P Ref.			N/A
Final Assessment			

5		6		7		8		9		10		
Assertions												
Valuation	Allocation	Presentation/	Disclosure									
												1
												2
												3
	N/A		N/A									4
												5
	✓		✓									6
												7
												8
	N/A		N/A									9
												10
												11
	N/A		N/A									12
												13
												14
	✓		✓									15
												16
	✓		✓									17
												18
												19
												20
												21
												22
												23
												24
												25
												26
												27
												28
												29
												30
												31
												32
												33
												34
												35
												36
												37
	Moderate		Moderate									38
												39
												40



# AAM Section 5000

## AUDIT APPROACH AND PROGRAMS

The material included in these sections on audit approach and programs is presented for illustrative purposes only. The comments, illustrative audit objectives and illustrative audit procedures are neither all-inclusive nor are they prescribed minimums. The illustrative audit procedures are numbered merely to organize the materials; those numbers are not intended to imply completeness or a prescribed sequence. The nature, extent and timing of the auditing procedures to be applied on a particular engagement are a matter of professional judgment to be determined by the auditor based on the specific facts and circumstances.

This manual is a nonauthoritative kit of practice aids. Accordingly, these sections include minimal explanation and discussion of authoritative pronouncements. Users of this manual are urged to refer directly to applicable authoritative pronouncements when appropriate. Users should also note that this manual does not deal with specialized industry problems; reference should be made to applicable AICPA Audit and Accounting Guides.

### TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
5100	Designing the Audit Program .....	.01-.41
	Financial Statement Assertions .....	.05
	Developing Audit Objectives .....	.06-.07
	Audit Tests .....	.08-.24
	Purpose of the Test .....	.11-.14
	Type of Test .....	.15
	Analytical Procedures .....	.16-.17
	Inquiry and Observation .....	.18-.19
	Tests of Transactions .....	.20-.22
	Tests of Balances .....	.23-.24
	Linking Audit Procedures to Objectives .....	.25-.26
	The Completeness Assertion .....	.27-.41
	Lack of Audit Evidence .....	.32-.35
	Internal Controls Structure Policies and Procedures for Completeness .....	.36-.37
	Substantive Tests .....	.38-.41
5200	Timing of Audit Tests .....	.01-.10
	Substantive Tests That Can Generally Be Applied at an Interim Date .....	.05-.07
	Conditional Substantive Tests .....	.08-.10
5300	Extent of Testing .....	.01-.39
	Authoritative Standards .....	.02-.07
	When SAS No. 39 Applies .....	.03-.07
	Authoritative Guidance About the Application of Audit Sampling to Substantive Tests Provided by SAS No. 39 .....	.08-.09
	Documentation Requirements in SAS No. 39 .....	.09
	Determining Extent of Testing in a Small Business Without Sampling .....	.10-.24
	Identification of Individual Items to Be Examined .....	.16-.17
	Is Extent of Evidential Matter Obtained Sufficient? .....	.18-.19
	Consider Contribution of Other Procedures .....	.20-.22

Section	Paragraph
<b>5300 Extent of Testing—continued</b>	
Evaluation of Sufficiency of Evidence . . . . .	.23-.24
Planning the Extent of Testing Using Audit Sampling for Substantive Tests . . . . .	.25-.39
Selection of a Representative Sample . . . . .	.26-.32
Determining Sample Size . . . . .	.33-.34
Projection of Error Based on Sample Results . . . . .	.35-.37
Statistical and Nonstatistical Sampling . . . . .	.38-.39
<b>5400 Illustrative Audit Program . . . . .</b>	<b>.010-.460</b>
I. General Procedures . . . . .	.030
A. Fieldwork . . . . .	.030
II. Internal Control Structure Policies and Procedures . . . . .	.040-.150
A. Revenues, Receivables, and Receipts—Audit Objectives . . . . .	.040
B. Revenues, Receivables, and Receipts—Assessment of Risk . . . . .	.050
C. Revenues, Receivables, and Receipts—Tests of Controls . . . . .	.060
D. Purchases, Accounts Payable, and Disbursements—Audit Objectives . . . . .	.070
E. Purchases, Accounts Payable, and Disbursements—Assessment of Risk . . . . .	.080
F. Purchases, Accounts Payable, and Disbursements—Tests of Controls . . . . .	.090
G. Payroll—Audit Objectives . . . . .	.100
H. Payroll—Assessment of Risk . . . . .	.110
I. Payroll—Tests of Controls . . . . .	.120
J. Inventories and Cost of Sales—Audit Objectives . . . . .	.130
K. Inventories and Cost of Sales—Assessment of Risk . . . . .	.140
L. Inventories and Cost of Sales—Tests of Controls . . . . .	.150
III. Cash . . . . .	.160-.180
A. Cash—Audit Objectives . . . . .	.160
B. Cash in Banks—Substantive Test Procedures . . . . .	.170
C. Cash Funds and Petty Cash—Substantive Test Procedures . . . . .	.180
IV. Investments . . . . .	.190-.200
A. Audit Objectives . . . . .	.190
B. Substantive Test Procedures . . . . .	.200
V. Trade Accounts and Notes Receivable . . . . .	.210-.220
A. Audit Objectives . . . . .	.210
B. Substantive Test Procedures . . . . .	.220
VI. Inventories . . . . .	.230-.246
A. Audit Objectives . . . . .	.230
B. Substantive Test Procedures—General . . . . .	.240
C. Before Observation of Physical Inventory . . . . .	.241
D. Observation of the Physical Inventory . . . . .	.242
E. Summarization—Physical Quantities . . . . .	.243
F. Prices and Summarization—Monetary Units . . . . .	.244
G. Lower of Cost or Market Considerations . . . . .	.245
H. Other . . . . .	.246
VII. Property and Equipment, and Related Depreciation . . . . .	.250-.260
A. Audit Objectives . . . . .	.250
B. Substantive Test Procedures . . . . .	.260
VIII. Prepaid Expenses, Deferred Charges, Intangibles, and Other Assets . . . . .	.270-.280
A. Audit Objectives . . . . .	.270
B. Substantive Test Procedures . . . . .	.280
IX. Accounts Payable . . . . .	.290-.300
A. Audit Objectives . . . . .	.290
B. Substantive Test Procedures . . . . .	.300
X. Accrued Liabilities Other Than Taxes . . . . .	.310-.320
A. Audit Objectives . . . . .	.310

<i>Section</i>	<i>Paragraph</i>
<b>5400 Illustrative Audit Program—continued</b>	
B. Substantive Test Procedures . . . . .	.320
XI. Income Taxes Accrued and Provided . . . . .	.330-.340
A. Audit Objectives . . . . .	.330
B. Substantive Test Procedures . . . . .	.340
XII. Notes Payable, Long-Term Debt, and Debt Equivalents . . . . .	.350-.360
A. Audit Objectives . . . . .	.350
B. Substantive Test Procedures . . . . .	.360
XIII. Stockholders' Equity . . . . .	.370-.381
A. Audit Objectives . . . . .	.370
B. Capital Stock and Additional Paid-In Capital—Substantive Test Procedures . . . . .	.380
C. Retained Earnings . . . . .	.381
XIV. Revenues and Other Income . . . . .	.390-.400
A. Audit Objectives . . . . .	.390
B. Substantive Test Procedures . . . . .	.400
XV. Operating and Other Expenses . . . . .	.410-.420
A. Audit Objectives . . . . .	.410
B. Substantive Test Procedures . . . . .	.420
XVI. Litigation, Claims, and Assessments . . . . .	.430-.440
A. Audit Objectives . . . . .	.440
B. Substantive Test Procedures . . . . .	.440
XVII. Subsequent Events . . . . .	.450-.460
A. Audit Objectives . . . . .	.450
B. Substantive Test Procedures . . . . .	.460

---

[The next page is 5101.]



# AAM Section 5100

## *Designing the Audit Program*<sup>1</sup>

.01 The objective of an audit is to express an opinion on whether financial statements present fairly in all material respects, an entity's financial position, results of operations, and cash flows in conformity with generally accepted accounting principles. This conclusion may be expressed only when the auditor has formed such an opinion on the basis of an audit performed in accordance with generally accepted auditing standards. The procedures that the auditor plans to use to gather evidence are outlined in an audit program.

.02 Since the audit program describes the evidence-gathering steps to be used in the audit, it should be carefully designed. Designing an audit program involves three major considerations:

- (1) Deciding *what* procedures to apply—the *nature* of audit tests
- (2) Deciding *when* to apply the procedures—the *timing* of audit tests
- (3) Deciding *which* items to apply the procedures to—the *extent* of audit tests

.03 Flowchart 1 presents an overview of the structure of the audit process. To design an audit program that is efficient and effective, the auditor should—

- (1) Identify the client's assertions regarding each material component of the financial statements.
- (2) Consider the risk of material misstatement.
- (3) Establish specific audit objectives relating to the assertions in the financial statements.
- (4) Determine the audit procedures to be performed to accomplish the audit objectives.
- (5) Determine when to perform the audit procedures.
- (6) Determine which of many items to apply audit procedures to.

.04 The six steps illustrated in flowchart 1 result in a determination of the nature, timing, and extent of audit tests.

### **Financial Statement Assertions**

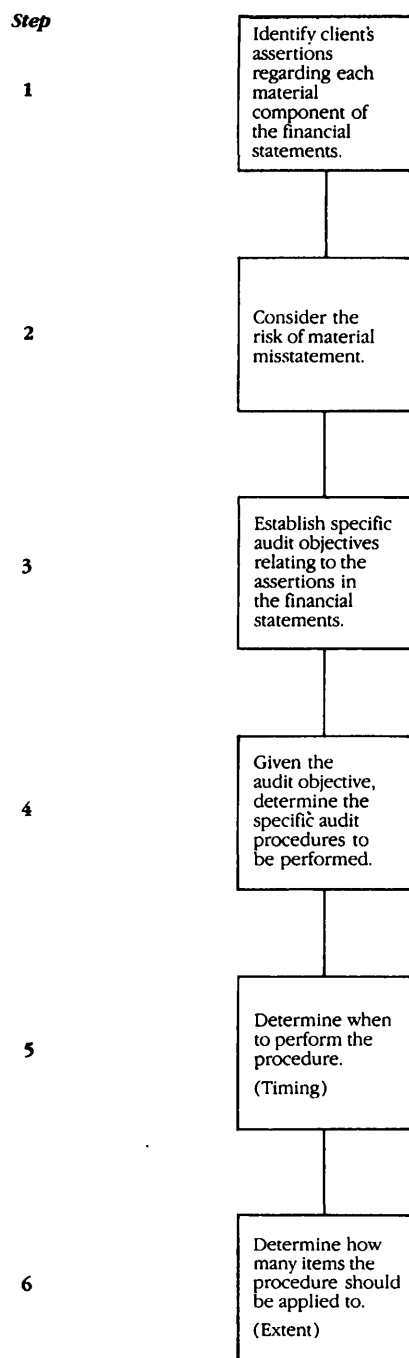
.05 According to SAS No. 31, *Evidential Matter* (AU section 326), the independent auditor's work in forming an opinion on financial statements consists of obtaining and evaluating evidential matter concerning the assertions in such financial statements. These assertions are embodied in the account balance, transaction class, and disclosure components of financial statements and are classified according to the following broad categories:

---

<sup>1</sup> AICPA Auditing Procedures Study, *Audits of Small Businesses*, 1985, pp. 29–40.



**Flowchart 1**  
**Audit Logic Process**



- (1) *Existence or Occurrence.* Reported assets and liabilities actually exist at the balance sheet date, and transactions reported in the income statement actually occurred during the period covered.
- (2) *Completeness.* All transactions and accounts that should be included in the financial statements are included, or there are no undisclosed assets, liabilities, or transactions.
- (3) *Rights and Obligations.* The company owns and has clear title to assets and liabilities are obligations of the company.
- (4) *Valuation or Allocation.* The assets and liabilities are valued properly, and the revenues and expenses are measured properly.
- (5) *Presentation and Disclosure.* The assets, liabilities, revenues, and expenses are properly classified, described, and disclosed in the financial statements.

## Developing Audit Objectives

.06 A misrepresentation of any of the five financial statement assertions could cause a material misstatement in the financial statements. The auditor should consider the risk of material misstatement for each assertion in the financial statements, and then obtain evidence to support the financial statement assertions to reduce the risk of material misstatement to an acceptably low level. To determine what type of evidence to obtain, the auditor develops specific audit objectives related to each assertion.

.07 In determining audit objectives, the auditor should evaluate each of the five assertions as they relate to the specific account balance or class of transactions being examined. For example, if the auditor is attempting to gather evidence on the assertion of *existence* of inventory, the auditor's objective would be to gather evidence that inventory included in the balance sheet physically existed at the date of the balance sheet.

### Relationship of Assertions and Objectives for Inventory

**Figure 1**

<u>Financial Statement Assertion</u>	<u>Illustrative Audit Objectives</u>
Existence or occurrence	—Inventories included in the balance sheet physically exist.
Completeness	—Inventory quantities include all products, materials, and supplies on hand. —Inventory quantities include all products, materials, and supplies owned by the client that are in transit or stored at outside locations. —Inventory listings are accurately compiled and the totals are properly included in the inventory accounts.
Right and obligations	—The entity has legal title or similar rights of ownership to the inventory.
Valuation or allocation	—Inventories are properly stated at cost (except when market is lower).
Presentation and disclosure	—Inventories are properly classified in the balance sheet as current assets.

An example of the relationship between financial statement assertions and audit objectives for inventory is shown in figure 1.

## Audit Tests

.08 After the auditor has determined the audit objectives, the method of achieving the objectives should be selected. Although these methods are referred to by various names such as audit procedures, audit techniques, and audit tests, they represent the evidence-gathering methods auditors use. The basic requirement for determining audit procedures, according to SAS No. 31, paragraph 12 (AU section 326.12), is that:

The procedures adopted should be adequate to achieve the audit objectives developed by the auditor, and the evidential matter obtained should be sufficient for the auditor to form conclusions concerning the validity of the individual assertions embodied in the components of financial statements.

.09 Some audit procedures can satisfy a combination of audit objectives for a given account balance or class of transactions. For example, the auditor's observation of a physical inventory count can provide evidence that inventories physically exist and that inventory quantities include all products, materials, and supplies on hand.

.10 Audit tests or procedures can be classified or categorized in a variety of ways. The most common classifications are by purpose of the test or by type of test.

### Purpose of the Test

.11 According to SAS No. 55, *Consideration of the Internal Control Structure in a Financial Statement Audit* (AU section 319), the purpose of performing audit tests are:

- a. To evaluate whether an internal control structure policy or procedure is operating effectively. These tests are referred to as tests of controls.
- b. To detect material misstatements in financial statement assertions. These tests are referred to as substantive tests.

.12 The substantive test that the auditor performs consists of tests of details of transactions and balances and analytical procedures. In assessing control risk, the auditor also may use tests of details of transactions as tests of controls. The objective of tests of details of transactions performed as substantive tests is to detect material misstatements in the financial statements. The objective of tests of details of transactions as tests of controls is to evaluate whether an internal control structure policy or procedure operated effectively. Although these objectives are different, both may be accomplished concurrently through performance of a test of details on the same transaction.

.13 If the control risk is assessed at less than the maximum level, the auditor should obtain sufficient evidential matter to support that assessed level. The evidential matter that is sufficient to support a specific assessed level of control risk is a matter of auditor judgment. The type of evidential matter obtained all bear on the degree of assurance provided. Since the auditor's substantive testing is affected by the quality of the internal control structure policies and procedures, the auditor is concerned with whether the controls established are designed and operating effectively. The role of tests of controls is to justify this assertion.

.14 The most effective and efficient audit strategy for a small business engagement generally is to assess the control risk at the maximum level (the greatest probability that a material misstatement that could occur in an assertion will not be prevented or detected on a timely basis by an entity's internal control structure). In this case, the auditor will use the knowledge obtained from the understanding of the internal control structure and the assessed level of control risk in designing substantive tests for financial statement assertions.

### Type of Test

.15 Auditors perform four types of tests:

- (1) Analytical procedures
- (2) Inquiry and observation
- (3) Tests of transactions
- (4) Tests of balances

The relationship of audit tests by purpose to audit tests by type is shown in figure 2.

## Analytical Procedures

.16 Analytical procedures are used for the following purposes:

- To assist the auditor in planning the nature, timing, and extent of other auditing procedures.
- As a substantive test to obtain evidential matter about particular assertions related to account balances or classes of transactions.
- As an overall review of the financial information in the final review stage of the audit.

.17 Analytical procedures involve comparisons of recorded amounts, or ratios developed from recorded amounts, to expectations developed by the auditor. Analytical procedures are discussed in SAS No. 56, *Analytical Procedures* (AU section 329).

## Inquiry and Observation

.18 Testing of internal control structure policies and procedures that leave no audit trail of documentary evidence is usually tested by observation and inquiry. Auditors make inquiries of different individuals and conduct observation tests to determine who performs a particular activity or how or when the activity is done. For example, the auditor may ask different individuals about who posts to the receivables ledger, the auditor may observe who prepares the bank reconciliation, or the auditor may observe when cash is deposited in the bank.

.19 Observation and inquiry can also be used as substantive tests. For example, an audit procedure such as observation of a *physical asset* to determine that it exists is a substantive test relating to the existence assertion. Likewise, inquiries regarding subsequent events would be a substantive test because they provide evidence regarding the adequacy of disclosures in the financial statements.

**Matrix of Audit Tests by Purpose and Type**

**Figure 2**

		Purpose of Test	
		Substantive Test	Test of Controls
Type of Test	Analytical Procedures	Yes Example A	No
	Observation and Inquiry	Yes Example H	Yes Examples B, C
	Tests of Transactions	Yes Example D	Yes Examples E, F
	Tests of Balances	Yes Examples G, H	No

### Examples:

A—Comparison of this year's expenses with last year's expenses

B—Observation by auditor that cash is deposited daily by a specific clerk

C—Inquiry by auditor about who deposits cash and how often

D—Examination of invoices to support additions (specific transactions) to fixed assets account during year

E—Examine sales invoices to see if initials of credit manager are there to indicate a credit file and credit approval (Inspection Test)

F—Vouch from sales invoices to credit files to see if customer has a credit file and has been approved for credit (Reperformance Test)

G—Confirmation of year-end balances in accounts receivable

H—Observation of the existence of a building

---

## Tests of Transactions

.20 Tests of transactions consist of the examination of the documents and accounting records involved in the processing of specific transactions. Such procedures can accomplish both testing of controls and substantive testing and are sometimes used concurrently.

.21 Tests of controls are accomplished when the auditor examines transaction documentation to determine if the internal control structure policies and procedures have been applied as prescribed. Tests of transactions can be classified as either inspection tests or reperformance tests. If the auditor examines documentation, the tests of controls are classified as an inspection test. Alternatively, if the auditor repeats an internal control structure policy and procedure performed by the client, the tests of controls are classified as reperformance tests. For example, an internal control structure policy and procedure may require employees to match vendors' invoices with purchase orders and receiving reports and then initial the invoices to indicate that the procedure was performed. If the auditor tests the control by examining invoices for initials, the test is an inspection test. If the auditor tests the control by comparing vendors' invoices with purchase orders and receiving reports, the test is a reperformance test. Regardless of whether the auditor tests by inspection or reperformance, the test of control is a test of transactions.

.22 The substantive objective of tests of transactions is accomplished when the auditor examines transaction documentation to determine if dollar errors exist in a balance. For example, if the auditor examines documentation supporting individual charges (debits) to an equipment account to determine that the account balance is fairly stated, the test is classified as a substantive test of transactions.

## Tests of Balances

.23 Tests of balances consist of examination of evidential matter directly supporting the ending balance in an account. Tests of balances are substantive tests designed to identify misstatements by a direct test of the ending balance rather than by testing the transactions that make up that balance.

.24 Substantive tests of transactions and tests of balances are interrelated in that each class of transactions affects a related account balance. Since financial statement amounts are the accumulation of transactions, an auditor may test the transactions that enter the account (that is, the debits and credits), the account balance itself (that is, the ending balance), or both.

## Linking Audit Procedures to Objectives

.25 To design an audit program, the auditor should select audit procedures that achieve specific audit objectives developed from the five broad assertions for each material account balance in the financial statements.

.26 In selecting audit procedures to achieve the audit objectives developed, an auditor considers the following, according to SAS No. 31:

- (1) The assessed level of control risk.
- (2) The relative risk of errors or irregularities.
- (3) The expected efficiency and effectiveness of possible audit procedures.
- (4) The nature and materiality of the items being tested.

- (5) The kinds and competence of available evidential matter.
- (6) The nature of the audit objective to be achieved.

## The Completeness Assertion

.27 SAS No. 31, paragraph 5 (AU section 326.05), discusses the completeness assertion:

Assertions about completeness deal with whether all transactions and accounts that should be presented in the financial statements are so included. For example, management asserts that all purchases of goods and services are recorded and are included in the financial statements. Similarly, management asserts that notes payable in the balance sheet include all such obligations of the entity.

.28 Substantive tests that provide assurance regarding the completeness assertion are those that provide evidence about whether all transactions have been captured by the client's accounting system and are included in the financial statements.

.29 Gathering evidence about whether all transactions have been recorded is one of the most difficult audit objectives to achieve. Evidence of completeness can be even more difficult to obtain when a client does not have a good internal control structure or has only an informal record-keeping system. Because these two characteristics often apply to small business, satisfying the completeness objective can be difficult for the auditor in a small business engagement.

.30 Completeness relates to whether all items have been included in the financial statements. The completeness assertion is violated if a transaction or account is omitted from the financial statements. If a transaction is merely recorded in the wrong account, there is no violation of the completeness assertion since the transaction is still recorded in the financial statements. In such a situation, the accounts are not incorrect because of a completeness error; rather, they are incorrect because of a classification error. A classification error is a violation of the presentation and disclosure assertion.

.31 For many accounts, the completeness assertion is the most difficult to test. The difficulty arises because the auditor must gather evidence about potential unrecorded items. Sources of audit evidence regarding unrecorded items often are not readily available.

## Lack of Evidence

.32 To give an unqualified opinion, the auditor must gather sufficient, competent evidential matter to reduce the level of audit risk to an appropriately low level. SAS No. 31, paragraph 22 (AU section 326.22), provides the following guidance when the auditor is unable to gather sufficient evidence to be satisfied regarding the completeness assertion:

To the extent the auditor remains in substantial doubt about an assertion of material significance, he must refrain from forming an opinion until he has obtained sufficient competent evidential matter to remove such substantial doubt or he must express a qualified opinion or a disclaimer of opinion.

.33 SAS No. 53, *The Auditor's Responsibility to Detect and Report Errors and Irregularities*, paragraph 8 (AU section 316.08), states:

The auditor should exercise (a) due care in planning, performing and evaluating the results of audit procedures, and (b) the proper degree of professional skepticism to achieve reasonable assurance that material errors or irregularities will be detected. Since the auditor's opinion on the financial statements is based on the concept of reasonable assurance, the auditor is not an insurer and his report does not constitute a guarantee.

.34 SAS No. 31, requires the auditor to obtain evidence concerning inclusion in the financial statements of all types of transactions that the auditor has reason to believe has occurred based on the auditor's knowledge of the client and the industry in which it operates. The excerpt from SAS No. 53 (AU section 316), refers to transactions which the auditor has reason to believe have occurred. Utilizing professional skepticism while performing the audit, this would require the auditor to question transactions which are peculiar to the particular client or industry as well as questioning the lack of specific types of transactions.

.35 The results of a recent research study on audit problems encountered in small business engagements (Auditing Research Monograph No. 5) indicates that many practitioners sometimes accept client representations as sufficient audit evidence when completeness of recorded transactions cannot be substantiated.<sup>2</sup> Client representations are part of the evidential matter the auditor gathers, but they should not be used as a substitute for the performance of those procedures considered necessary to form an opinion on the financial statements. An auditor cannot rely on client representations alone as sufficient audit evidence to substantiate the completeness of account balances and classes of transactions. When an auditor is unable to form an opinion, even though representations from the client have been received, there is a limitation on the scope of the audit that precludes the auditor from issuing an unqualified opinion (SAS No. 19, *Client Representations*, paragraph 12 [AU section 333.12]).

### Internal Control Structure Policies and Procedures for Completeness

.36 Internal controls for completeness include policies and procedures that are designed (1) to count or otherwise identify transactions executed by the entity and (2) to provide reasonable assurance that all transactions have been accurately recorded by the accounting system. For example, completeness controls over purchases can include reconciliation of all pre-numbered receiving reports (which would be required for all goods received) to recorded purchases and investigation of receiving reports that are missing, not recorded, or not otherwise accounted for. Many auditors prefer to rely on controls when gathering evidence of completeness since extensive substantive tests for completeness may be more difficult to design than those for other SAS No. 31 assertions.

.37 If the auditor desires to assess control risk at less than the maximum level, tests of controls should be performed to determine that the controls are working as prescribed to make that control risk assessment. Once the control risk is assessed at less than maximum, the auditor may restrict substantive procedures designed to obtain evidential matter regarding the completeness assertion. Taken alone, the assessed level of control risk, ordinarily, is not sufficiently low to eliminate the need to perform any substantive tests. In addition, small businesses often lack segregation of duties, which usually prevents the auditor from assessing control risk at a low level. As a result, it is necessary to perform substantive tests of the completeness assertion.

### Substantive Tests

.38 Many substantive tests are of limited usefulness in detecting errors of omission because they are usually applied to recorded amounts. Unrecorded transactions are not included in the account balances or classes of transactions to which the auditor applies substantive tests.

.39 Of all the financial statement assertions, only completeness involves consideration of whether there are material amounts that are not included in the account balance or class of transactions being tested. Therefore, substantive tests of the completeness assertion differ somewhat from substantive tests of other financial statement assertions. The difference is highlighted by the following excerpt from SAS No. 31, paragraph 11 (AU section 326.11):

In designing substantive tests to achieve an objective related to the assertion of existence or occurrence, the auditor selects from items contained in a financial statement amount and searches for relevant evidential matter. On the other hand, in designing procedures to achieve an objective related to the assertion of completeness, the auditor selects from

---

<sup>2</sup> D.D. Raiborn, Auditing Research Monograph No. 5, *Audit Problems Encountered in Small Business Engagements* (New York: AICPA, 1982), p. 74.

evidential matter indicating that an item should be included in the relevant financial statement amount and investigates whether that item is so included.

.40 Substantive tests can be designed to provide evidential matter to support a conclusion that specific account balances are not misstated by amounts that would cause the financial statements, taken as a whole, to be materially misstated because of unrecorded transactions.

.41 Important sources of evidential matter for completeness include source documents, such as order logs, shipping and receiving documents, and checks. One common test of completeness involves tracing amounts from source documents to amounts recorded in the accounting records. For example, the auditor may vouch selected cash disbursements after the end of the audit period to test the completeness of amounts recorded as accounts payable at the balance sheet date. Other substantive procedures that provide evidence concerning the completeness of financial statement account balances include the following:

- (1) Sales-and-purchases cutoff procedures that include tracing shipping and receiving documents processed after the audit period to accounting records for the proper period.
  - (2) Analytical procedures in which the auditor investigates relationships among data that indicate a financial statement account or balance may be understated. For example, the auditor may obtain evidence that all interest-bearing debt is recorded by examining the relationship between recorded interest expense and the average balance of interest-bearing debt outstanding for the period. Disproportionate relationships based on the auditor's knowledge of interest rates should be investigated. Other examples include: a comparison of investment income to average investments for the period to test whether income earned on investments is recorded; the relationship of average pay times number of employees to payroll expense to substantiate that salaries are recorded; and the relationship of membership fee revenue to the number of members of an organization.
  - (3) Confirmations of balances or transactions designed to identify unrecorded amounts, such as accounts payable confirmations that request the creditor to specify the amount of the client's obligation.
  - (4) Tests of bank reconciliations, including examination of checks clearing the bank after the audit period to identify cash disbursements processed but not recorded or inappropriately recorded in the subsequent period.
  - (5) Reading the minutes of the meetings (of the) board of directors and stockholders and tracing transactions authorized in the minutes to amounts recorded in the accounting records.
  - (6) Overall reconciliations using financial and nonfinancial data, such as "proofs" of cash and sales.
- 

[The next page is 5201.]





# AAM Section 5200

## *Timing of Audit Tests*<sup>1</sup>

.01 During the planning stage of the audit, the auditor should consider *when* to apply audit tests. In a small business engagement, the auditor typically assesses control risk at the maximum level and does not perform tests of controls. As a result, the question of when to perform audit tests in small business engagements frequently applies only to substantive testing.

.02 The determination of whether substantive tests can or should be applied prior to year-end is usually based on practical considerations. In making that determination, the auditor evaluates the benefits of performing a substantive test prior to year-end against the potential costs of performing such interim work.

.03 For example, the auditor considers whether the benefits of easing pressures caused by a tight year-end reporting deadline outweigh the cost of gathering additional audit evidence necessitated by the use of a less effective test at an interim date.

.04 Substantive tests can be divided into two categories: those that can generally be applied at an interim date and those that *may be* efficient at an interim date only if certain conditions are met.

### **Substantive Tests That Can Generally Be Applied at an Interim Date**

.05 Some substantive tests can generally be performed through any date prior to year-end and still be efficient and effective tests. Substantive tests that fall into this category are tests that apply to data readily available prior to year-end. Such tests include:

- (1) Substantive tests of transactions to support balance sheet accounts (for example, supporting the details of additions and retirements to a fixed asset account)
- (2) Substantive tests of transactions to support income statement accounts (for example, reviewing all charges over a certain dollar amount to the repairs-and-maintenance account)
- (3) Analytical procedures that include calculations on an interim basis (for example, comparing actual and budgeted expenses for each month)

.06 In each of these tests, the auditor reviews information that is already available at an interim date. Even if these tests were done at year-end, the same information would be needed and the same procedure performed. Thus, these tests generally can be efficient when performed at an interim date.

.07 For example, auditors frequently support those balance sheet accounts with low activity, such as fixed assets, by analyzing the transactions within the account during the year. Consequently, for property, plant, and equipment the auditor can audit the account by analyzing material additions and retirements rather than by testing the ending balance. To support additions the auditor may vouch material additions to invoices. Vouching such invoices may be performed before year-end without reducing the efficiency or effectiveness of the test. At year-end, the auditor still may have to vouch invoices from the interim date to year-end. However, these invoices would have to be vouched regardless of whether the interim work was performed.

### **Conditional Substantive Tests**

.08 Other substantive tests may be efficient when applied prior to year-end only if certain conditions are met. Generally, such substantive tests should only be applied prior to year-end if substantive tests for the remaining period from the interim date to year-end can be restricted.

---

<sup>1</sup> AICPA Auditing Procedures Study, *Audits of Small Businesses*, 1985, pp. 57—59.

.09 SAS No. 45, *Omnibus Statement on Auditing Standards*, describes several factors that should be considered before applying substantive tests to details of balance sheet accounts at interim dates. Those factors relate to the ability to control the additional risk of not detecting errors that may exist at the balance-sheet date when the balance is tested at an interim date. Factors described include:

- (1) Whether the effectiveness of the tests will be impaired because of the auditor's assessment of the control risk
- (2) Whether rapidly changing business conditions or circumstances might predispose management to misstate the financial statements between an interim date and year-end
- (3) Whether the year-end balances of the particular balance sheet accounts are reasonably predictable with respect to amount, relative significance, and composition

.10 In many small business engagements, the cost of bringing the additional risk to an acceptably low level is too great. SAS No. 45 notes that "applying substantive tests . . . at an interim date may not be cost-effective if substantive tests to cover the remaining period cannot be restricted due to the assessment of control risk." In the case of a small business with limited segregation of duties, these substantive tests are generally not performed at an interim date because to do so would be inefficient. For example, in a small business engagement, the auditor generally audits cash, accounts receivable, inventory, and accounts payable at year-end.

---

[The next page is 5301.]

# AAM Section 5300

## *Extent of Testing*<sup>1</sup>

.01 Once an auditor decides what audit procedures to apply (the nature of the tests) and when to apply them (the timing of the tests), a decision must be made about how many items to apply the procedures to—that is, the extent of testing.

### Authoritative Standards

.02 SAS No. 39, *Audit Sampling* (AU section 350), addresses a variety of issues relating to the auditor's use of sampling in an audit engagement. However, SAS No. 39 does not always apply when the auditor is examining less than 100 percent of a population. There has been some confusion in practice over when SAS No. 39 applies.

### When SAS No. 39 Applies

.03 Audit sampling is only one of many tools used by auditors to obtain sufficient, competent evidential matter to support an opinion on financial statements. SAS No. 39 discusses design, selection, and evaluation considerations to be applied by the auditor when using audit sampling. As a general rule, audit sampling can be used—

- (1) In tests of controls in the internal control structure that provide an audit trail of documentary evidence.
- (2) In substantive tests of details of transactions and balances.
- (3) In dual-purpose tests that test compliance with a control procedure providing documentary evidence of performance and accuracy of the recorded monetary amount of transactions or balances.

.04 The portion of SAS No. 39 pertaining to tests of control applies when sampling techniques are used to test controls. The portion pertaining to substantive tests apply when sampling techniques are used to test details of transactions or balances.

.05 SAS No. 39 defines audit sampling as “the application of an audit procedure to less than 100 percent of the items within an account balance or class of transactions for the purpose of evaluating some characteristic of the balance or class.” The key to understanding that definition is the *intent* of the auditor in applying the audit procedure. As noted in SAS No. 39, footnote 1 the auditor may examine less than 100 percent of the items in an account balance or in a class of transactions for reasons other than evaluating a characteristic of the balance or class. For example, the auditor would not be performing audit sampling in the following two situations:

- (1) Tracing several sales transactions through a client's accounting system to gain an understanding of the manner in which transactions are processed. SAS No. 39 would not apply because the auditor's intent is to gain an understanding of the processing of these transactions by the accounting system, not to evaluate a characteristic of all sales transactions processed by the accounting system.
- (2) Examining several large sales invoices that constitute a significant portion of the account balance and leaving the remaining portion of the balance untested or testing the remaining items by other means, such as the application of analytical procedures. Again, SAS No. 39 does not apply because the auditor is treating the account balance as two populations. For the large sales invoices, the auditor is not sampling since the population (all large sales invoices) is being examined. For the small sales invoices, the auditor is not sampling either because there is no examination of the items or because analytical procedures are performed.

---

<sup>1</sup> AICPA Auditing Procedures Study, *Audits of Small Businesses*, 1985, pp. 61—72.

.06 In determining whether SAS No. 39 is applicable to circumstances in which an auditor examines less than 100 percent of the items making up an account balance or class of transactions, the auditor should consider the purpose of the test. If the auditor intends to project the test results to the entire account balance or class of transactions for the purpose of evaluating a characteristic of the balance or class, the guidance in SAS No. 39 should be followed. For example, if the auditor intends to examine selected sales invoices to draw a conclusion about whether sales are overstated, audit sampling as described in SAS No. 39 should be applied because the auditor intends to draw a conclusion about all sales. On the other hand, if the auditor selects several large sales invoices for certain audit tests and then applies analytical procedures to the remaining invoices, the auditor is not sampling according to SAS No. 39—the examination of the large items is not intended to lead the auditor to a conclusion about the other items. In that case, any conclusion about whether sales are overstated would be based on the combined results of the test of large sales invoices, inquiry and observations, analytical procedures, and other auditing procedures performed related to overstatement of sales.

.07 The auditor should remember that the way in which the population is defined can determine whether the requirements of SAS No. 39 apply. The auditor might choose to divide a single reporting line on the financial statements into several populations. For example, accounts receivable might be divided into wholesale receivables, retail receivables, and employee receivables. Each of these populations can be tested using a different audit strategy—some using audit sampling and others not. The sampling concepts in SAS No. 39 apply only to populations for which audit sampling is used. Use of audit sampling on one population does not mandate its use on remaining populations.

### **Authoritative Guidance About the Application of Audit Sampling to Substantive Tests Provided by SAS No. 39**

.08 There has been confusion in the accounting profession regarding what requirements are imposed by SAS No. 39. SAS No. 39 added the following seven specific provisions to professional standards.

- (1) The concept that some items exist for which, in the auditor's judgment, acceptance of some sampling risk is not justified, and that these should be examined 100 percent (paragraph 21 [AU section 350.21]). This simply reminds the auditor that some of the items encountered in an examination of financial statements may be so significant individually or may have such a high likelihood of being in error or misstated that *all* such items should be examined.
- (2) The suggestion that the efficiency of a sample may be improved by separating items subject to sampling into relatively homogeneous groups based on some characteristic (paragraph 22 [AU section 350.22]). This indicates that audit efficiency can sometimes be improved by, for example, stratifying or segregating the items constituting a balance or class of transactions into groups based on individual dollar value or some other characteristic.
- (3) A requirement that the auditor consider tolerable error in planning audit sampling applications in the examination of account balances and classes of transactions (paragraph 18 [AU section 350.18]). This asks the auditor to consider, in the early stages of an audit, how much error the auditor will be able to tolerate for each balance and class of transactions that is sampled, in combination with errors in other accounts, and still render an unqualified opinion on the financial statements. SAS No. 39 asks the auditor to consider tolerable error and to recognize that it is one of the factors influencing sample size. There is no requirement to document or quantify tolerable error.
- (4) A requirement that the auditor select a sample that can be expected to be representative of the pertinent account balance or class of transactions (paragraph 24 [AU section 350.24]). Simply put, this means that each item in the population being sampled should have a *chance* of being selected, not necessarily an *equal chance* of being selected. This does not mean that the auditor is required to use a random or probability sample.

- (5) A requirement that the auditor consider selected sample items to which the auditor is unable to apply planned audit procedures to determine their effect on the evaluation of the sample (paragraph 25 [AU section 350.25]). For example, sometimes the auditor may not be able to apply planned audit procedures to selected sample items because supporting documentation may be missing. If the auditor's evaluation of the sample results would not be altered by considering those unexamined items to be in error, it is not necessary to examine the items. However, if considering those unexamined items to be misstated would lead to a conclusion that the balance or class is materially in error, the auditor should consider alternative procedures that would provide sufficient evidence to form a conclusion.
- (6) A requirement that the auditor project the error results of the sample to the items from which the sample was selected (paragraph 26 [AU section 350.26]). Since the sample is expected to be representative of the population from which it was selected, errors found are also expected to be representative of the population. This merely asks the auditor to measure the likely error in the population from which the sample was drawn and to consider it in reaching conclusions.
- (7) A requirement that the auditor consider, in the aggregate, projected error results for all audit sampling applications and all known errors from nonsampling applications when evaluating whether the financial statements taken as a whole may be materially misstated (paragraph 30 [AU section 350.30]).

### Documentation Requirements in SAS No. 39

.09 SAS No. 39 contains no new or specific documentation requirements. However, the documentation standards set forth in the Statements on Auditing Standards dealing with documentation apply to audit sampling applications just as they apply to other auditing applications. For example, SAS No. 22, *Planning and Supervision* (AU section 311), states that the auditor should prepare a written audit program and SAS No. 41, *Working Papers* (AU section 339), requires the auditor to prepare working papers recording the work that the auditor has done and the conclusions that the auditor has reached concerning significant matters. Thus, with regard to audit sampling applications, the audit program might document such items as the objectives of the sampling application and the audit procedures related to those objectives. Documentation might also include the definition of the population and the sampling unit, including: (1) how the auditor considered completeness of the population, (2) the definition of error, (3) the method of sample selection, (4) a list of errors identified in the sample, (5) an evaluation of the result of the sampling application, and (6) conclusions reached by the auditor.

### Determining Extent of Testing in a Small Business Without Sampling

.10 Small businesses have certain characteristics that may influence the auditor's decision to use audit sampling. Because of the limited segregation of duties common in small businesses, auditors frequently choose to assess control risk at the maximum level, so generally the auditor of a small business will not have to consider tests of controls, including sampling of documentary evidence, to determine if controls are working as prescribed.

.11 For substantive testing, small businesses frequently have small populations of accounting data in both account balances and classes of transactions. Consequently, sampling may not be as useful since there may not be large populations of data.

.12 As noted previously, SAS No. 39, paragraph 1 (AU section 350.01), defines audit sampling: "The application of an audit procedure to less than 100 percent of the items within an account balance or class of transactions for the purpose of evaluating some characteristic of the balance or class." This definition allows some alternative approaches to sampling to determine the extent of testing in a small business engagement. These alternatives, by not using audit sampling and thus eliminating the requirements of SAS No. 39, may provide a more effective and efficient audit approach for a small business engagement.

.13 These alternative approaches include:

- (1) Procedures applied to 100 percent of a certain group (strata) of transactions or balances.

- (2) Testing unusual items without applying procedures to the remainder of the population.
- (3) Other tests that involve application of procedures to less than 100 percent of the items in the population without drawing a conclusion about the entire account or class of transactions.

.14 As previously noted, the auditor should decide what audit procedures to perform to meet the established audit objectives. Once this decision is made, the auditor needs to determine the extent of testing.

.15 An effective and efficient approach to determining the extent of testing in a small business engagement is shown in flowchart 1. This approach involves four important steps.

### Identification of Individual Items to Be Examined

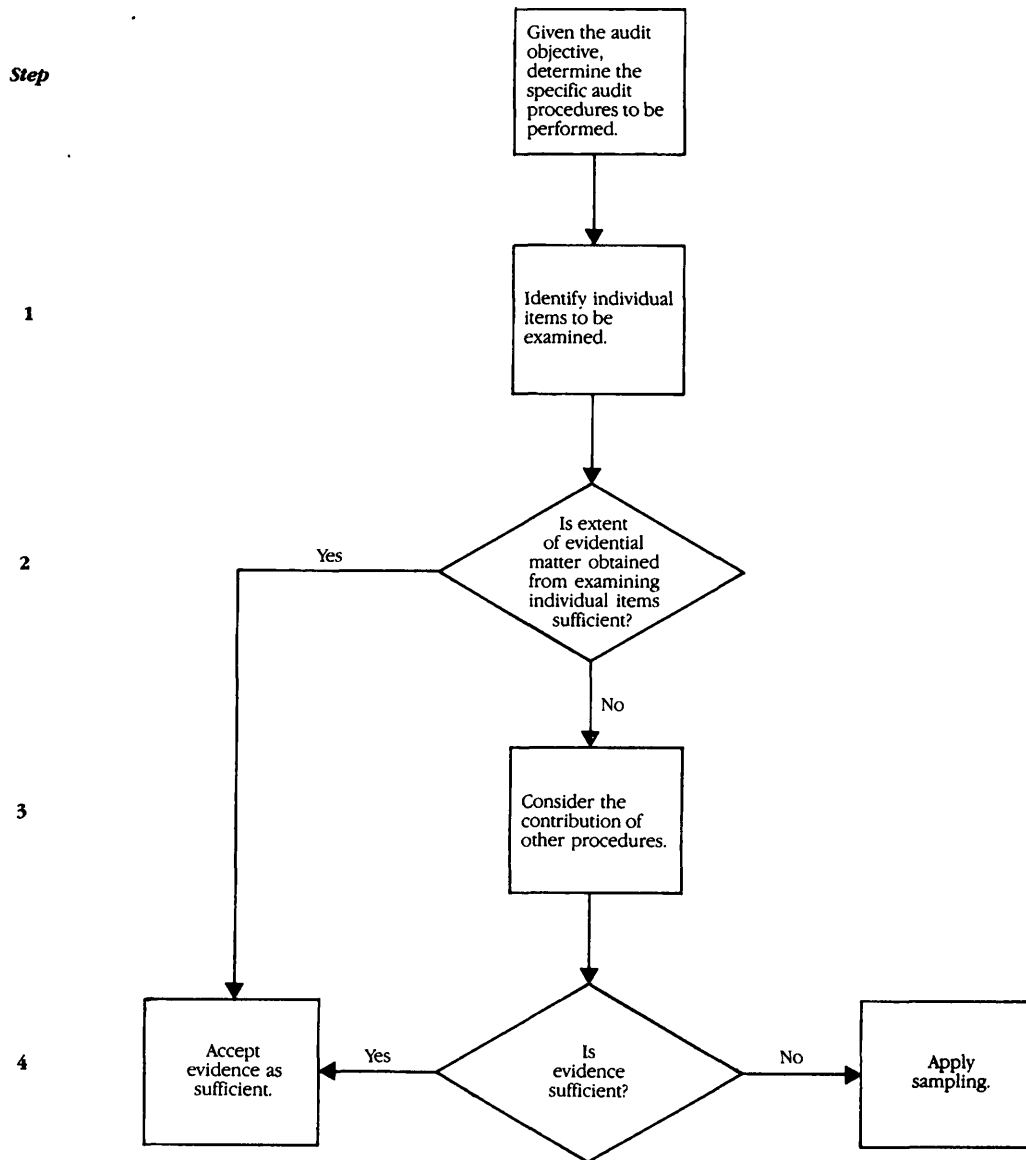
.16 An auditor should apply professional judgment in determining which individual items in an account balance or class of transactions need to be examined. In evaluating individual items, the auditor should consider factors such as size of the item, whether the item is unusual, prior experience with the client, and whether the item involves a related party.

.17 For example, consider the following information for accounts receivable of a small business.

<i>Number of Accounts</i>	<i>Balances</i>	<i>Total Accounts</i>
4	\$100,000 or more	\$ 625,000
7	\$25,000-99,999	375,000
62	\$1-24,999	300,000
<u>73</u>		<u>\$1,300,000</u>

In this case, if the eleven largest accounts are confirmed by the auditor, most of the accounts receivable balance is supported (\$1,000,000 out of \$1,300,000, or 77 percent). Also, the auditor may decide to confirm the receivables that have unusual characteristics (for example, receivables with either large credit balances or those that are very delinquent).

**Flowchart 1**  
**An Audit Sampling Approach for a Small Business**





### Is Extent of Evidential Matter Obtained Sufficient?

.18 Three factors that have been identified for auditors to consider in evaluating whether the evidential matter obtained by testing individual items is sufficient are the following:

- (1) Similarity of items tested to remaining population. The auditor may obtain some knowledge of the type of items in the remaining population if the items tested are very similar in nature and the same accounting system is used to process the transactions.
- (2) Indications of problems. In the course of the audit, the auditor may become aware of facts that indicate a problem with the remaining untested population of items in the account balance or class of transactions. In that case, the auditor should consider extending the tests to the remaining population through sampling or other means.
- (3) Size of items tested compared to total balance. As the number of items tested and the resulting dollar amount increases, the potential need to use sampling or other tests of the remaining population may decrease if there is a relatively low risk of an undetected material misstatement among the remaining undetected items.<sup>2</sup>

.19 If an auditor has examined a substantial number of individual amounts and found no evidence of problems from the other procedures performed—and the remaining population totals less than an amount that would be material to the financial statements—there is often no need to sample the remaining population. Otherwise, the auditor should extend tests to the remaining population unless an alternative approach can be justified.

### Consider Contribution of Other Procedures

.20 The auditor should also consider whether other evidence obtained contributes to conclusions regarding the account balance or class of transactions. The auditor often considers the contribution of other procedures at the same time the extent of evidential matter obtained from examining individual items is considered.

.21 The auditor may use a combination of analytical procedures and substantive tests of details to support an opinion on the financial statements. A small business audit does not typically include assessing control risk at less than the maximum level, so the auditor would rely primarily on analytical procedures and other substantive tests of details. In deciding whether other audit procedures make a contribution, the auditor should consider whether they support the audit objectives in the area, whether they indicate potential problems, and whether the evidence is consistent with the previous evidence obtained.

.22 In considering the contribution of other procedures, the auditor should use professional judgment in determining whether an unqualified opinion can be given without performing additional tests in the form of audit sampling.

### Evaluation of Sufficiency of Evidence

.23 There are three factors that the auditor may consider in evaluating the sufficiency of audit evidence obtained from examining individual items and contributed by other procedures, and in determining whether the remaining items in the population should be tested.

.24 First, the auditor should consider whether the dollar amount of the remaining population is equal to or greater than an amount that would be material to the financial statements. If the remaining population is less than material, the auditor may decide that no additional testing by sampling is necessary. Second, the auditor should consider the degree of risk involved (that is, how susceptible the account is to misstatement, and whether there

---

<sup>2</sup> Douglas R. Carmichael, Dennis R. Meals, Bruce N. Huff and Jerry Anderson, *Guide to Audits of Small Businesses* (Fort Worth, Texas: Practitioners Publishing Co., 1984).

have been problems with this area in prior audits). Third, the auditor should consider the sufficiency of all the audit evidence obtained so far (the extent of evidential matter obtained by testing individual items along with the contribution of other procedures).

## Planning the Extent of Testing Using Audit Sampling for Substantive Tests

.25 If the auditor decides to use audit sampling, the question becomes whether to sample statistically or nonstatistically. Regardless of the approach used, the auditor should—

- (1) Use a selection method expected to be representative.
- (2) Select a sample size that is adequate, giving consideration to materiality, audit risk, and population characteristics.
- (3) Project error based on sample results.

## Selection of a Representative Sample

.26 SAS No. 39 merely requires that the sample be selected in such a way that it is expected to be representative of the population. There is no requirement in SAS No. 39 that random-sampling selection methods be used. Representative sampling methods used by auditors include *haphazard sampling*, *systematic sampling*, and *random sampling*.

.27 Haphazard sampling consists of selecting sampling units without any conscious bias—that is, without any special reason for including or omitting items from the sample. Haphazard sampling does not imply that units can be selected in a careless manner. Rather, a haphazard sample is selected in a manner that can be expected to be representative of the population. For example, if the physical representation of the population is a file cabinet drawer of vouchers, a haphazard sample of all vouchers processed for a year might include any of the vouchers that the auditor pulls from the drawer, regardless of each voucher's size, shape, location, or physical features. The auditor using haphazard selection should avoid distorting the sample by selecting, for example, only unusual or physically small items or by omitting items such as the first or last items in the population.

.28 In selecting a haphazard sample, the auditor may select the sample either with each item having an approximately equal chance of selection (neutral selection) or with the larger dollar-value items being emphasized (value-oriented selection). Both methods are appropriate haphazard-sample selection techniques meeting the requirement of SAS No. 39 that the sample be selected so that it is expected to be representative. In the case of neutral selection, the sample is expected to be representative of the *items* in the population. In the case of value-oriented selection, the sample is expected to be representative of the *dollars* in the population. Value-oriented selection using haphazard sampling is a general approximation of sample selection using probability-proportional-to-size sampling (dollar-unit sampling).

.29 Systematic sampling consists of determining a uniform interval and selecting throughout the population one item at each of the uniform intervals from the starting point.

.30 Random-number sampling entails matching random numbers generated by a computer or selected from a random-number table with, for example, document numbers.

.31 Another method that has been used in practice is block sampling. Block sampling consists of selecting groups of sequential items (for example, all vouchers processed on several selected dates). Using block samples is usually inefficient because, for a block sample to be adequate to lead to an audit conclusion, a relatively large number of blocks should be selected. In general, auditors should avoid using block sampling; however, if an auditor decides to use block sampling, special care should be exercised to control sampling risk in designing the sample.

.32 The AICPA Audit and Accounting Guide, *Audit Sampling*, contains a thorough description of these methods as well as other guidance on statistical and nonstatistical sampling methods.

## Determining Sample Size

.33 There is no rule-of-thumb appropriate for the determination of a sample size in all applications. SAS No. 39 imposes no requirement to use quantitative aids, as sample size tables, to determine sample size—nor does SAS No. 39 impose a rule regarding minimum sample size. As before the issuance of SAS No. 39, professional judgment is the key. Auditors often use benchmarks or starting points, such as sample sizes used in prior years or in similar circumstances in other audit engagements, in determining what sample size is appropriate for a given sampling application. If the auditor uses a benchmark, the factors listed in SAS No. 39, paragraph 23 (AU section 350.23), that influence the auditor's judgment in determining sample size for substantive tests should be considered. Those factors include (1) tolerable error, (2) the allowable risk of incorrect acceptance, and (3) the characteristics of the population (for example, the variability of the amounts of items in the population and the expected error in the population). An analysis of the factors that influence sample size for substantive testing is shown in figure 1.

.34 Individual firms or auditors often prefer to set their own rules regarding a benchmark or starting point for determining sample size. SAS No. 39 does not require such policies. It merely alerts the auditor to factors to be considered.

## Projection of Error Based on Sample Results

.35 SAS No. 39 requires the auditor to project the results of the sample to the items in the population from which the sample was selected. There are several methods that satisfy the requirement of SAS No. 39 to project the sample error to the population. Two such methods are presented in the AICPA Audit and Accounting Guide, *Audit Sampling*.

### (1) *Using ratio of population dollars to sample dollars*

$$\text{Amount of sample error} \times \frac{\text{Population dollars}}{\text{Sample dollars}} = \text{Projected population error}$$

If the auditor has identified \$1,000 of sample errors, sample dollars are \$10,000, and population dollars are \$100,000, the projected error would be calculated as:

$$\$1,000 \times \frac{\$100,000}{\$10,000} = \$10,000 \text{ Projected population error}$$

### (2) *Using ratio of population items to sample items (rather than dollars)*

$$\text{Sample error} \times \frac{\text{Population items}}{\text{Sample items}} = \text{Projected population error}$$

If the auditor has identified \$1,000 of sample errors in examining 100 items out of 1,000 items in the population, the calculation in the example would be as follows:

$$\$1,000 \times \frac{1,000}{100} = \$10,000 \text{ Projected population error}$$

**Factors Influencing Substantive Test Sample Sizes**

**Figure 1**

<i>Factor</i>	<i>Conditions Leading To</i>		<i>Relationship to Sample Size</i>
	<i>Smaller Sample Size</i>	<i>Larger Sample Size</i>	
Reliance on internal control structure	Assessed control risk at below maximum level	Assessed control risk at below maximum level	Inverse
Reliance on other substantive tests related to same account balance or class of transactions	Substantial reliance to be placed on other substantive tests	Little or no reliance to be placed on other substantive tests	Inverse
Measure of tolerable error for a specific account	Larger measure of tolerable error	Smaller measure of tolerable error	Inverse
Expected size and frequency of errors	Smaller errors or lower frequency	Larger errors or higher frequency	Direct
Population value	Smaller monetary significance to the financial statements	Larger monetary significance to the financial statements	Direct
Number of items in population	Virtually no effect on sample size unless population is small		Direct
Overall assurance required	Lower overall assurance	Higher overall assurance	Direct
Stratification	Stratification of the population	No stratification of the population	Inverse

*Note:* All that SAS No. 39 requires is that these concepts be considered in thinking about what sample size should be used. It doesn't require that they be quantified.

Extent of Testing

.36 These two methods produce the same result if the fraction represented by the proportion of population items to sample items is the same as the fraction represented by the proportion of population dollars to sample dollars. In practice, however, those fractions are usually not the same and the two methods do not usually produce the same result. If there is a significant difference in the two ratios, the auditor should consider whether there is reason to expect a relationship between errors and the size of the item. If the error relates to the size of the item, the auditor should use the first method. If errors are relatively constant for all items, the auditor should select the second method. For example, assume the auditor is examining accounts receivable and notes that some receivables are incorrect. If the observed errors are unrelated to the size of the receivable, then the auditor should use the second method (Population Items to Sample Items). Alternatively, if the observed errors vary in size depending on the size of the receivable (that is, larger receivables have larger errors), the auditor should use the first method (Population Dollars to Sample Dollars).

.37 The auditor should calculate projected error for each individual group or strata sampled. The projected error for such groups should then be added to the actual error found in the items that were examined 100 percent. The total is the projected error for the account or class of transactions.

### Statistical and Nonstatistical Sampling

.38 SAS No. 39 does not require that the auditor use either nonstatistical or statistical sampling. SAS No. 39 allows the auditor to use either method based on the auditor's professional judgment, factoring in the relative costs and benefits of each of the approaches.

.39 The Audit and Accounting Guide, *Audit Sampling*, demonstrates both statistical and nonstatistical sampling approaches to compliance and substantive testing.

---

[The next page is 5401.]

# AAM Section 5400

## *Illustrative Audit Program*

.010 Some audit procedures (for example, tracing the bank balance per the bank reconciliation to the confirmation received from the bank) lend themselves to routine language. To draft this type of routine language for each engagement is time consuming. As a result, some auditors maintain lists of illustrative audit objectives and audit procedures as sources of routine language to save time when developing audit programs for specific engagements. Other auditors may refer to copies of programs from previous or similar engagements for the same purpose. In either case, the source of routine language is a mere manuscript aid subject to the auditor's professional judgment. The auditor's professional judgment must be applied in deciding whether the program includes all of the procedures required in the particular circumstances. The manuscript aid serves solely as a timesaver. Users of manuscript aids must remain alert to needs such as the following:

- Developing steps for required procedures which are not covered by the manuscript aid.
- Excluding extraneous and unnecessary procedures which are covered by the manuscript aid.
- Editing or modifying the manuscript to suit the needs and preferences of the auditor in the circumstances.

.020 Following is a list of illustrative audit objectives and procedures which are numbered merely to organize the materials; the numbers are not intended to imply completeness or a prescribed sequence. This list is merely illustrative. Some auditors may find the items too wordy, others may find them too terse, and still others may prefer a different set of items organized in a different manner. Users of this material must use professional judgment and be alert for the important matters in a particular set of circumstances which may not be covered in the illustrative material.

.021 The illustrative audit program contemplates assessing control risk at less than the maximum level. If the auditor assesses control risk at the maximum level and does not restrict substantive tests, it may be necessary to extend such tests to compensate for assessing control risk at less than the maximum level. See AAM section 3165 for an illustrative audit planning checklist.

<u>Done By</u>	<u>Date</u>	<u>W/P Ref.</u>
--------------------	-------------	---------------------

**I. General Procedures****A. .030 Fieldwork**

- |   |       |       |       |
|---|-------|-------|-------|
| 1. For trial balances and other schedules and analyses prepared by the client, perform the following: |       |       |       |
| a. Trace amounts to the general ledger  | _____ | _____ | _____ |
| b. Re-perform the footings and crossfootings (test basis may be appropriate)                          | _____ | _____ | _____ |
| c. Trace opening balances to final balances per the working papers for the preceding year (period).   | _____ | _____ | _____ |
| 2. Communicate internal control structure related matters noted (see SAS No. 60 [AU section 325]).    | _____ | _____ | _____ |
| 3. Obtain written representation from management of the client (SAS No. 19 [AU section 333]).         | _____ | _____ | _____ |

Note: Many firms include other matters in the general sections of programs, such as disposition of proposed adjustments, report preparation and review, reconciliation of actual and estimated time, preparation of fee estimate for next year, evaluation of staff, etc.

This audit program section has been completed in accordance with firm policy.

Date

Done by \_\_\_\_\_

Reviewed by \_\_\_\_\_

Done By	Date	W/P Ref.
------------	------	-------------

## II. Internal Control Structure Policies and Procedures

### A. .040 Revenues, Receivables, and Receipts—Audit Objectives

1. The auditor must obtain a sufficient understanding of the design of relevant policies and procedures which relate to revenue account balances and transactions and whether they have been placed in operation.

_____	_____	_____
-------	-------	-------

### B. .050 Revenues, Receivables, and Receipts—Assessment of Risk

1. Document the understanding of internal control structure (the form and extent of documentation is influenced by the size and complexity and nature of the internal control structure).

_____	_____	_____
-------	-------	-------

2. Assess the level of control risk.

- a. If control risk is assessed at less than the maximum level, the basis for this conclusion should be documented. The auditor should also obtain sufficient evidential matter to support this assessed level. An example of some evidential matter to support this assessed level is as follows:

Selecting a sample of sales transactions representing each major type of sale; trace each selected transaction through the related documents and records from inception to ultimate disposition, noting the following:

1. Authorization of the transaction(s) in accordance with prescribed procedure. (For example, approval of sales orders or job orders based on a customer's purchase order or executed job contract; prior approval of the customer's credit; comparison of prices with an authorized price list, etc.)

_____	_____	_____
-------	-------	-------

2. Evidence of completion and shipment of the customer's order. (For example, carrier's bill of lading, receipt signed by the customer, etc.)

_____	_____	_____
-------	-------	-------

3. Evidence of billing and recording of the sale and related charge to cost of sales. (For example, sales invoice recorded in the sales journal and accounts receivable subsidiary ledger; credit to inventory and charge to cost of sales recorded based on the completed job order.)

_____	_____	_____
-------	-------	-------

4. Evidence of collection as a cash receipt. (For example, trace transaction to the entry for the related remittance (as a collection on an individual billing or monthly statement billing) recorded in the accounts receivable subsidiary ledger, cash receipts journal, and its inclusion in the daily deposit recorded on the bank statement.)

_____	_____	_____
-------	-------	-------

- b. If control risk is assessed at the maximum level, document this conclusion (the basis for the conclusion need not be documented). (As stated in AAM section 5400.021, if the control risk is assessed at this level the auditor will have to expand tests to compensate for this level of control risk.)

_____	_____	_____
-------	-------	-------

3. Based on the assessed level of control risk the timing and extent of substantive tests may be affected in, for example, the following aspects:

- a. Extent and method of selection of accounts for confirmation.

_____	_____	_____
-------	-------	-------

- b. Use of positive or negative forms of confirmation request, or a combination of both.

_____	_____	_____
-------	-------	-------

- c. Timing of confirmation procedures.

_____	_____	_____
-------	-------	-------

- d. Type of information needed on the confirmation request to facilitate responses.

_____	_____	_____
-------	-------	-------

- e. Anticipated scope of alternative procedures as to significant accounts which do not respond to confirmation requests.

_____	_____	_____
-------	-------	-------

- f. Nature and extent of tests to substantiate sales cutoff.

_____	_____	_____
-------	-------	-------

- g. Nature and extent of tests to substantiate deferral and realization of revenue in such situations as unearned subscription income of unearned finance charges on installment receivables.

_____	_____	_____
-------	-------	-------



	Done By	Date	W/P Ref.
h. Approach to reviewing and evaluating adequacy of the allowance provided for doubtful accounts (review of allowances for specific accounts, comparison of experience relating to write-offs with sales and receivables, and the client's past and present credit policies and practices, etc.).	_____	_____	_____
<b>C. .060 Revenues, Receivables, and Receipts—Tests of Controls</b>			
1. Evaluate whether a further reduction in the assessed level of control risk is justified. ("Justify" here means it is likely that a further reduction is available and that it would be efficient to perform additional tests of control to obtain that evidential matter.) If so, proceed to step 2 below, otherwise go to the next system of internal control structure. (AAM section 5400.080)	_____	_____	_____
2. Obtain the sales journal and for a selected period(s):			
a. Trace totals from the sales journal to the general ledger control accounts for revenues, receivables and such other accounts as salesmen's commissions, provisions, and allowances for product warranties, etc.	_____	_____	_____
b. Trace selected individual items from the sales journal to such other subsidiary records as the salesmen's commissions detail, and entries to charge cost.	_____	_____	_____
c. Reconcile the sales journal to the entries to charge cost of sales and credit inventory.	_____	_____	_____
d. Test the arithmetic accuracy of the footings and crossfootings of the journals.	_____	_____	_____
3. Select . . . entries from the sales journal made at various times throughout the year, obtain the supporting documents and perform the following tests:			
a. Compare the sales invoices with the entries in the sales journal for invoice date, invoice number, identity of customer, dollar amount, and any related items such as sales tax, salesmen's commissions, etc.	_____	_____	_____
b. Trace the sales invoice to the accounts receivable subsidiary (customers) ledger and to evidence of subsequent payment (remittance advice and cash receipts records).	_____	_____	_____
c. Compare the sales invoice for customer identity, description of product, price, quantities, and amounts, to the applicable sales order, and customer's purchase order or job contract. Note evidence of approval of prices and credit as prescribed by management.	_____	_____	_____
d. Compare customer identity, description of product, and quantities per the sales invoice to the documents evidencing shipment; test computations of related freight and insurance charges. Ascertain whether sales are recorded in the proper months.	_____	_____	_____
e. Trace prices, discount, and payment terms to such sources as price lists, job quotations, and job contracts.	_____	_____	_____
f. Test arithmetic accuracy of extensions, footings, and computation of discounts. Note evidence of performance of a clerical check by client staff, where applicable.	_____	_____	_____
g. If the client charges cost of sales and credits inventory as items are sold, trace detail per the sales invoice to subsidiary records for cost of sales and inventory.	_____	_____	_____
4. Review the numerical sequence file of shipping orders for a selected period and account for missing numbers.	_____	_____	_____
5. Select . . . shipping orders prepared at various times during the year. Obtain related sales invoices and trace them to the sales journal. Note whether billings are timely for shipments made.	_____	_____	_____
6. Select . . . credit memorandums issued at various times during the year; ascertain whether credits were authorized in accordance with prescribed procedure; review available supporting documentation; trace the memorandums to the sales journal or other appropriate journal and to the accounts receivable subsidiary ledger. If the credit is granted for return of goods, inspect evidence of return and ascertain whether accounting for the returned goods is consistent with reported condition of the returned goods.	_____	_____	_____

	Done By	Date	W/P Ref.
7. Obtain the cash receipts journal and perform the following on a test basis for a selected period(s):			
a. Trace totals to the general ledger for both the cash account and applicable account distributions such as accounts receivable, cash sales, investment income, and additions to notes payable (re: proceeds).	_____	_____	_____
b. Test the arithmetic accuracy of the footings and crossfootings of the cash receipts journal; reconcile total receipts to total deposits per the bank statement.	_____	_____	_____
8. From the cash receipts journal, select . . . cash receipts entered during the year; obtain the supporting remittance advices and perform the following:			
a. Compare the remittance advices with applicable entries per the cash receipts journal and trace to deposits per the bank statement(s). Ascertain the promptness of the deposit and recording of the entries.	_____	_____	_____
b. Trace detail posting of cash receipts to the accounts receivable, notes receivable, or other appropriate subsidiary ledger. Ascertain whether cash receipts and related credits to accounts receivable are recorded consistently in the proper period.	_____	_____	_____
9. Evaluate the internal control structure for shipments, sales, discounts, sales returns, credits allowed, cash receipts, and trade receivables (see SAS No. 55 [AU section 319]) and:			
a. Record matters considered and conclusions reached in making the evaluation in accordance with firm policy (completion of questionnaires, checklists, preparation of required memoranda, etc.).	_____	_____	_____
b. Based on the evaluation, make necessary modifications to applicable sections of the program for substantive tests.	_____	_____	_____
c. Identify and note reportable conditions in internal control structure to be brought to the client's attention (SAS No. 60 [AU section 325]).	_____	_____	_____
d. Identify and note other internal control structure matters to be brought to the client's attention.	_____	_____	_____
<b>D. .070 Purchases, Accounts Payable, and Disbursements—Audit Objectives</b>			
1. The auditor must obtain a sufficient understanding of the design of relevant policies and procedures which relate to classification of costs or expenses and charges to accounts such as property and equipment and prepaid expenses and whether they have been placed in operation.	_____	_____	_____
<b>E. .080 Purchases, Accounts Payable, and Disbursements—Assessment of Risk</b>			
1. Document the understanding of the internal control structure (the form and extent of documentation is influenced by the size and complexity and nature of the internal control structure).	_____	_____	_____
2. Assess the level of control risk.			
a. If control risk is assessed at less than the maximum level, the basis for this conclusion should be documented. The auditor should also obtain sufficient evidential matter to support this assessed level. An example of some evidential matter to support this assessed level is as follows:			
Selecting a sample of processed invoices representing each major type of purchase transaction; trace each selected transaction through the related documents and records from inception to ultimate disposition, noting the following:			
1. Authorization in accordance with prescribed procedures. (For example, properly approved purchase orders or blanket purchase orders, executed term contracts such as leases and service agreements, properly approved requests for payments, etc.)	_____	_____	_____
2. Evidence of receipt of the goods or services. (For example, receiving reports or such equivalents as receiving copies of purchase orders, approval of utility and service billings by designated operating management, advice of engineers or consultant on performance of services, etc.)	_____	_____	_____

	Done By	Date	W/P Ref.
3. Evidence of processing the vendor's invoice and approval before payments. (For example, matching with an approved purchase order and with footings recomputed, indication of proper account distribution date, and signature or initials indicating approval for payment.)	_____	_____	_____
4. Evidence of the processed invoice(s) indicating reference to the specific payment made and sufficiently prominent cancellation to avoid duplicate payment.	_____	_____	_____
5. Evidence of payment (examine the paid check(s) and (i) compare check number, date, identity of payee, and amount to the processed invoice(s); (ii) trace signatures on the check(s) to a list of authorized check signers; and (iii) compare the endorsement to the name of the payee for reasonableness (identity with name of payee or guarantee of endorsement by a bank).	_____	_____	_____
6. Recording of paid check(s) in cash disbursement journal as to check number, date, name of payee, amount, and account distribution.	_____	_____	_____
7. If an accounts payable or voucher register is used, evidence that the processed invoice(s) is correctly recorded in the voucher register as to voucher number, date, identity of payee, amount, and account distribution.	_____	_____	_____
b. If control risk is assessed at the maximum level, document this conclusion (the basis for the conclusion need not be documented). (As stated in AAM section 5400.021, if the control risk is assessed at this level the auditor will have to expand tests to compensate for this level of risk.)	_____	_____	_____
3. Based on the assessed level of control risk the timing and extent of substantive tests may be affected in, for example, the following aspects:			
a. Extent of analytical procedures and tests of details of transactions and balances regarding classification of costs or expenses and charges to accounts such as property and equipment and prepaid expenses.	_____	_____	_____
b. Time interval between receiving goods and services and invoicing by vendors (may affect design and extent of cutoff tests).	_____	_____	_____
c. Extent of testing of details of transactions and balances to substantiate recorded payables and search for unrecorded liabilities as of the balance sheet date.	_____	_____	_____
d. Need for and extent of confirmation of payables from vendors.	_____	_____	_____
e. The number of days following the balance sheet date for which cutoff bank statements should be obtained.	_____	_____	_____
f. The extent to which (if any) tests of cash balances can be performed at interim dates.	_____	_____	_____
g. The extent to which testing of outstanding checks, deposits in transit, and other reconciling items can be restricted.	_____	_____	_____
h. The number of days before and after the balance sheet date which should be used for the testing of bank transfers.	_____	_____	_____
i. Whether all bank transfers during the selected period or only those over a selected dollar amount should be tested.	_____	_____	_____
j. Whether petty cash funds should be counted or confirmed with the custodian as of the balance sheet date.	_____	_____	_____
k. Whether petty cash funds should be counted on a surprise basis.	_____	_____	_____
l. The need for coordination of cash counts with inspection of marketable securities and other investments.	_____	_____	_____
<b>F. .090 Purchases, Accounts Payable, and Disbursements—Tests of Controls</b>			
1. Evaluate whether a further reduction in the assessed level of control risk is justified. ("Justify" here means it is likely that a further reduction is available and that it would be efficient to perform additional tests of control to obtain that evidential matter.) If so, proceed to step 2 below, otherwise go to the next system of internal control structure. (AAM section 5400.110)	_____	_____	_____
2. Obtain the voucher register and for a selected period(s):			

	Done By	Date	W/P Ref.
a. Trace postings to other subsidiary registers, if used (for example, property tax register).	_____	_____	_____
b. Test the arithmetical accuracy of the footings and crossfootings of the voucher register for a test period(s).	_____	_____	_____
c. Trace totals to the general ledger for both accounts (vouchers) payable and the various account distributions.	_____	_____	_____
3. Select . . . entries from the voucher register for various months throughout the year, obtain supporting documents and perform the following tests:			
a. Compare the entry in the voucher register of the vendor's invoice as to date, payee, description, and amount and test the clerical accuracy of the invoice.	_____	_____	_____
b. Determine that the invoice is supported by (i) an approved purchase order or payment request form and, if applicable, a properly executed purchase requisition and (ii) a signed receiving report or other evidence of receipt of services or goods.	_____	_____	_____
c. Determine that the account distribution in the voucher register is reasonable and in agreement with the purchase order.	_____	_____	_____
d. Determine that purchase discounts have been properly recorded.	_____	_____	_____
e. Determine that freight has been billed in conformity with the purchase order.	_____	_____	_____
f. Examine the cancelled check issued in payment of the invoice for date, payee, amount, signature, and endorsement. Trace to cash disbursements journal.	_____	_____	_____
g. Inspect the voucher for evidence of clerical check, approval of payment as prescribed by management, and appropriate cancellation.	_____	_____	_____
4. Review the numerical sequence files of receiving reports and of purchase orders and determine whether missing numbers are accounted for. (Failure by the client to do so increases the risk that unrecorded liabilities may exist.)	_____	_____	_____
5. Obtain the cash disbursements journal and perform the following on a test basis:			
a. Trace postings for a selected period(s) to the general ledger for both the cash accounts and applicable account distributions.	_____	_____	_____
b. Trace postings for a selected period(s) to other applicable subsidiary records, if present (for example, voucher or purchase journal, insurance and property tax registers, plant ledger, etc.).	_____	_____	_____
c. For a selected period(s), foot and crossfoot the cash disbursements journal; reconcile total disbursements to the bank statement.	_____	_____	_____
6. Review the numerical sequence of checks issued for a selected period and account for missing numbers as void or included on the list of outstanding checks. Select . . . checks drawn at various times during the year from the disbursements journal and obtain the paid checks and supporting detail for the disbursements:			
a. Examine the paid checks and trace identity of signatures to the list of authorized check signers. (Consider requesting confirmations from banks of authorized check signers.)	_____	_____	_____
b. Compare identity of payee to endorsement; review checks for unusual endorsements and schedule those found for further investigation.	_____	_____	_____
c. Compare paid check and supporting detail to the cash disbursements journal for check number, date drawn, payee, amount, and account distribution.	_____	_____	_____
7. Review the client's bank reconciliations; for a selected period(s) perform the following tests of the bank reconciliation(s) and related listings of outstanding checks:			
a. Prove the arithmetic accuracy of the bank reconciliation, including the list of outstanding checks.	_____	_____	_____
b. Trace the bank balance to the bank statement and the book balance to the general ledger account.	_____	_____	_____
c. Trace the paid checks accompanying the bank statement to the cash disbursements journal and outstanding check list for the preceding month-end.	_____	_____	_____

	<u>Done By</u>	<u>Date</u>	<u>W/P Ref.</u>
d. Trace deposits per the bank statement to the cash receipts journal and deposits in transit per bank reconciliations of the preceding month-end.	_____	_____	_____
e. Trace deposits in transit to the bank statement for the following month; note whether the time interval between the dates per book and bank appear reasonable.	_____	_____	_____
f. Trace outstanding checks to paid check which accompanies the bank statement for the month(s) subsequent to the reconciliation tested; compare paid checks to the cash disbursements journal and inspect signature(s) and endorsements.	_____	_____	_____
g. Trace other reconciling items to supporting documents and check subsequent disposition.	_____	_____	_____
8. Consider preparing a proof of cash for a test period including the tests described in step 7 above and the following:			
a. Trace totals per the cash receipts and disbursements journals to the general ledger cash accounts; identify and obtain explanations for significant and unusual cash entries in the general ledger during the test period. Foot the receipts and disbursements journals and prove the arithmetic between the opening and closing general ledger cash balances for the test period.	_____	_____	_____
b. Prove the arithmetic accuracy of the bank statement by footing the deposits and disbursements, adding the opening balance and deducting the closing balance and ascertaining that the resulting differences equals total disbursements.	_____	_____	_____
c. Account for all deposits per books as deposits per bank or deposits in transit. Determine that deposits are made on a timely basis.	_____	_____	_____
d. Review the numerical sequence of checks issued during the period, accounting for them as paid during the period, included on the list of outstanding checks, or void. Determine that void checks have been properly mutilated.	_____	_____	_____
Note: The working paper format for step 8 would present reconciliations of total receipts and disbursements per the cash books to the respective total credits and charges per the bank statement(s) in addition to reconciliations of the bank and book balances at the beginning and end of the selected period. This working paper format may be used to reconcile total activity per the cash books and bank statements for various time periods such as a month or several months.			
9. Select the paid check(s) to reimburse the petty cash fund(s) from the cash disbursements journal; examine the voucher and paid check for consistency with the disbursement journal and prescribed approval and account distribution, and perform the following tests:			
a. Foot supporting evidence by account distribution and trace total to reimbursement voucher.	_____	_____	_____
b. Trace reimbursement voucher to cash disbursements journal and petty cash book.	_____	_____	_____
c. Examine petty cash vouchers for the following:			
(1) Prepared in ink	_____	_____	_____
(2) Approved	_____	_____	_____
(3) Cancelled after reimbursement	_____	_____	_____
(4) Dated	_____	_____	_____
(5) Payee	_____	_____	_____
(6) Amount	_____	_____	_____
(7) Signature	_____	_____	_____
(8) Account charged	_____	_____	_____
(9) Numbered consecutively	_____	_____	_____
(10) Reasonableness of amount and business purpose	_____	_____	_____

	Done By	Date	W/P Ref.
10. Assess the effectiveness of internal control structure policies and procedures for purchasing, receiving, processing, and payment of vendors' invoices (see SAS No. 55 [AU section 319]) and:			
a. Record matters considered and conclusions reached in making the evaluation in accordance with firm policy (completion of questionnaires, checklists, preparation of required memoranda, etc.).	_____	_____	_____
b. Based on the evaluation, make necessary modifications to applicable sections of the program for substantive tests.	_____	_____	_____
c. Identify and note reportable conditions in internal control structure to be brought to the client's attention (SAS No. 55 [AU section 319]).	_____	_____	_____
d. Identify and note other internal control structure matters to be brought to the client's attention.	_____	_____	_____
<b>G. .100 Payroll—Audit Objectives</b>			
1. The auditor must obtain a sufficient understanding of the design of relevant policies and procedures which relate to the payroll account balances and transactions and whether they have been placed in operation.	_____	_____	_____
<b>H. .110 Payroll—Assessment of Risk</b>			
1. Document the understanding of the internal control structure (the form and extent of documentation is influenced by the size and complexity and nature of the internal control structure).	_____	_____	_____
2. Assess the level of control risk.			
a. If control risk is assessed at less than the maximum level, the basis for this conclusion should be documented. The auditor should also obtain sufficient evidential matter to support this assessed level. An example of some evidential matter to support this assessed level is as follows:			
Selecting a sample of employees from the payroll registers representing each major type of payroll transaction. (For example, employees compensated on an hourly basis, on a piece-work basis, on a salary basis subject to overtime, and salesmen compensated on a commission basis, also, officers' salaries, employees paid by check and paid by cash, etc.) Trace each selected transaction through the related documents and records from inception to ultimate disposition, noting the following:			
1. Authorization of rate of pay. (For example, memoranda in the personnel files evidencing approval as prescribed by management, union contracts, approved rate or salary schedules, authorization of officers' salaries per minutes of board of director's meetings.)	_____	_____	_____
2. Evidence in support of payment. For example:			
a. Time cards or records, which have been approved as prescribed, for employees paid on an hourly basis and for employees paid for overtime.	_____	_____	_____
b. Production reports, which have been approved as prescribed, for employees paid on a piece-work basis.	_____	_____	_____
c. Sales and commission registers, and evidence that advance drawings for commission salesmen had been approved as prescribed.	_____	_____	_____
3. Evidence in support of payroll withholdings. (For example, signed W-4 forms or other proper authorization.)	_____	_____	_____
4. Evidence of review of payroll for clerical accuracy, reasonableness, and account distribution, as prescribed by management.	_____	_____	_____
5. Evidence of individual payroll records. (For example, the individual payroll entry to the records used to accumulate year to date employee compensation for such purposes as preparation of payroll tax returns and W-2 forms.)	_____	_____	_____
b. If control risk is assessed at the maximum level, document this conclusion (the basis for the conclusion need not be documented). (As stated in AAM section 5400.021, if the control risk is assessed at this level the auditor will have to expand tests to compensate for this level of risk.)	_____	_____	_____

	Done By	Date	W/P Ref.
3. Based on the assessed level of control risk the timing and extent of substantive tests may be affected in, for example, the following aspects:			
a. The extent to which analytical procedures are applied to payroll costs and expenses and the extent to which fluctuations are investigated.	_____	_____	_____
b. Whether, and to what extent, gross pay is reconciled to individual earnings records.	_____	_____	_____
c. Whether, and to what extent, a payoff is made.	_____	_____	_____
d. The extent to which labor charges to property and equipment and to inventory are tested.	_____	_____	_____
e. The extent to which payroll taxes withheld and accrued are tested.	_____	_____	_____
<b>I. .120 Payroll—Tests of Controls</b>			
1. Evaluate whether a further reduction in the assessed level of control risk is justified. ("Justify" here means it is likely that a further reduction is available and that it would be efficient to perform additional tests of control to obtain that evidential matter.) If so, proceed to step 2 below, otherwise go to the next system of internal control structure. (AAM section 5400.140)	_____	_____	_____
2. Obtain the payroll register for a selected period(s):			
a. Trace totals per the register through applicable payroll summaries to the paid check used to transfer cash for net pay to the payroll bank account, and to postings in the general ledger (and cost accounting records, if applicable) for wage and salary cost and expense distributions, and liabilities for payroll withheld and deducted.	_____	_____	_____
b. Trace payroll withheld through applicable subsidiary records to the payroll tax returns. Review the payroll tax returns; examine the check remitting withholdings to the governments (federal and state) and trace to the general ledger liability accounts.	_____	_____	_____
c. Determine whether payroll was approved in accordance with prescribed procedures. (For example, approval might be a signature on a payroll summary and request for the deposit of net pay to the payroll bank account; the signature on the check used to transfer money to the payroll bank account; approvals directly on the registers; etc.)	_____	_____	_____
d. Test the arithmetical accuracy of the footings and crossfootings of the payroll register.	_____	_____	_____
3. Select . . . entries from the payroll register made at various times throughout the year, and perform the following procedures:			
a. Examine authorization for rate of pay and evidence in support of payment (for example, time records, piece-work production reports or other documentation which has been approved as prescribed by management) and on a test basis recompute gross pay.	_____	_____	_____
b. Examine proper authorizations for payroll withholdings such as signed W-4 forms and on a test basis recompute amounts withheld.	_____	_____	_____
c. Test arithmetical accuracy of net pay based on gross pay less deductions.	_____	_____	_____
d. Examine cancelled checks noting date, check number, name of payee and comparing net pay to the payroll register, signature to list of authorized check signers, and endorsement to the signed W-4 forms.	_____	_____	_____
e. Examine signed receipt for employees paid by cash, compare amount on the receipt with the payroll register and compare signature to the signed W-4 form.	_____	_____	_____
f. Compare the individual payroll entry on the payroll register to the records used to accumulate year-to-date employee compensation for such purposes as preparation of payroll tax returns and W-2 forms.	_____	_____	_____
4. Consider, based on the preliminary evaluation, whether to:			
a. Observe the distribution of payroll checks or cash, including control of unclaimed wages.	_____	_____	_____

	Done By	Date	W/P Ref.
b. Physically observe selected employees in the performance of their duties.	_____	_____	_____
5. Evaluate internal control structure for payroll, including cost and expense account distributions, liabilities for payroll withheld and deducted and related payroll taxes (see SAS No. 55 [AU section 319]) and:			
a. Record matters considered and conclusions reached in making the evaluation in accordance with firm policy (completion of questionnaires, checklists, preparation of required memoranda, etc.).	_____	_____	_____
b. Based on the evaluation, propose necessary modifications to applicable sections of the program for substantive tests.	_____	_____	_____
c. Identify and note reportable conditions in internal control structure to be brought to the client's attention (SAS No. 55 [AU section 319]).	_____	_____	_____
d. Identify and note other internal control structure matters to be brought to the client's attention.	_____	_____	_____
<b>J. .130 Inventories and Cost of Sales—Audit Objectives</b>			
1. The auditor must obtain a sufficient understanding of the design of relevant policies and procedures which relate to inventory costs of sales account balances and transactions and whether they have been placed in operation.	_____	_____	_____
<b>K. .140 Inventories and Cost of Sales—Assessment of Risk</b>			
Note: Some auditing procedures may serve to accomplish the purposes of both tests of controls and substantive tests. Certain steps that are listed here as illustrative tests of controls are also listed among illustrative substantive tests for inventory. They are listed here because they serve to clarify and confirm the auditor's understanding of the internal control structure for inventory and cost of sales. They are listed as substantive tests because they provide evidence with respect to the clients accounting for costs of sales and cost of inventory.			
Tour the client's manufacturing or production facilities with a member of the client's organization familiar with production.			
1. Document the understanding of the internal control structure (the form and extent of documentation is influenced by the size, complexity, and nature of the internal control structure).	_____	_____	_____
2. Assess the level of control risk.			
a. If control risk is assessed at less than the maximum level, the basis for this conclusion should be documented. The auditor should also obtain sufficient evidential matter to support this assessed level.			
Note: Matters to consider in making the assessment include, but are not limited to, the following:			
1. Nature of client's operations and inventories.	_____	_____	_____
2. Physical location of inventories.	_____	_____	_____
3. How costs of material, direct labor, and overhead are accumulated; this may be coordinated with the assessment of the control risk for purchases and payroll and includes the assessment of the cost accounting system used (job order, process, standard costs, etc.).	_____	_____	_____
4. Accounting principles followed in assigning costs to inventory (FIFO, LIFO, retail method, etc.)	_____	_____	_____
5. Whether perpetual inventory records are used and, if so, how they are tested.	_____	_____	_____
6. Frequency and method of physically counting the inventory and adjusting the records to the physical.	_____	_____	_____
7. Procedures relating to inventories and cost of sales are closely related or the same as those reviewed for sales, purchases, and payroll. Thus the procedures utilized to assess risk for those areas may also be used for inventory and costs of sales.	_____	_____	_____



	Done By	Date	W/P Ref.
b. If control risk is assessed at the maximum level, document this conclusion (the basis for the conclusion need not be documented). (As stated in AAM section 5400.021, if the control risk is assessed at this level the auditor will have to expand tests to compensate for this level of risk.)	_____	_____	_____
3. Based on the assessed level of control risk the timing and extent of substantive tests may be affected in, for example, the following aspects:			
a. The extent to which physical inventories are observed and/or perpetual records tested.	_____	_____	_____
b. Whether physical inventories are taken at a preliminary date or at the balance sheet date.	_____	_____	_____
c. The extent to which consigned inventories are confirmed.	_____	_____	_____
d. The extent to which inventory prices are tested to supporting documentation.	_____	_____	_____
e. The extent to which analytical procedures are applied to cost of sales and the extent to which fluctuations are investigated.	_____	_____	_____
f. The extent to which cutoffs are tested.	_____	_____	_____
g. The extent to which inventories are tested for obsolete or excess stock.	_____	_____	_____
<b>L. .150 Inventories and Cost of Sales—Tests of Control</b>			
1. Evaluate whether a further reduction in the assessed level of control risk is justified. ("Justify" here means it is likely that a further reduction is available and that it would be efficient to perform additional tests of control to obtain that evidential matter.) If so, proceed to step 2 below, otherwise proceed to AAM section 5400.230—.246.	_____	_____	_____
2. Note: Some auditing procedures may serve to accomplish the purposes of both tests of controls and substantive tests. Certain steps that are listed here as illustrative tests of controls are also listed among illustrative substantive tests for inventory. They are listed here because they may serve to clarify and confirm the auditor's understanding of the internal control structure of inventory and cost of sales. They are listed as substantive tests because they provide evidence with respect to the client's accounting for cost of sales and cost of inventory. Tour the client's manufacturing or production facilities with a member of the client's organization familiar with production.	_____	_____	_____
3. Select a sample of transactions for additions and deletions of inventory from such sources as receiving reports, requisitions to place materials into production, and shipping documents. Note the reference or control number, date, description, quantity and dollar amount for each transaction selected. Trace the transactions to the perpetual inventory record and the cost accounting records, if any, used to determine unit or job costs. Perform similar tests selecting the transactions from the perpetual inventory records and/or cost accounting records and trace the transactions to receiving reports, requisitions, and shipping documents.	_____	_____	_____
Note: This testing may be coordinated with compliance tests for purchases, payables, and disbursements, and for revenues, receivables, and receipts.			
4. Obtain an analysis of overhead costs charged to inventories and over- or under-absorbed overhead. Review the amounts included in the overhead pool for propriety and perform the following:			
a. Determine that overhead costs are being charged to inventory in accordance with an appropriate policy (for example, as a percent of direct labor).	_____	_____	_____
b. Identify disposition of variances, if any, between actual overhead costs incurred and overhead costs applied to production and inventory. Determine that variances are reasonable. Determine that no excessive costs for idle plant are being charged to inventory.	_____	_____	_____
5. If a job order cost system is used, obtain the job order ledger (or tabulation), select a period(s) and perform the following:			
a. Trace total costs incurred to the voucher register (or cash disbursements journal), the payroll distribution, and support for overhead applied.	_____	_____	_____

	Done By	Date	W/P Ref.
b. Test the footings of the job order ledger by refooting the detail for selected subtotals and refooting the subtotals.	_____	_____	_____
c. Select . . . job orders for jobs in process and completed jobs and perform the following:			
(1) Examine authorization for the job order.	_____	_____	_____
(2) Trace materials used on a test basis at various times since inception of the job order to such supporting details as requisitions, purchase orders, receiving reports, and processed invoices. (Consider coordination with compliance tests for purchases.)	_____	_____	_____
(3) Trace direct labor costs to account distributions of the payroll registers and on a test basis to individual time reports or time cards. (Consider coordination with tests of controls for payroll.)	_____	_____	_____
(4) Trace application of overhead costs to analyses used to accumulate overhead costs; test computations and review for reasonableness.	_____	_____	_____
(5) Identify the status of the job (work in process, finished goods, or goods shipped) and trace through necessary summarization to the applicable general ledger account. Obtain explanation for any unreasonable time lag between completion and shipping dates for job orders performed for specific customers.	_____	_____	_____
6. For process cost systems, obtain the cost of production reports for each department within the production process for a selected period(s) and:			
a. Trace quantities and dollar amounts for units received for selected departments to the quantities and dollar amounts transferred out per the preceding department in the sequence of production.	_____	_____	_____
b. For each selected department, review the computations of total and unit costs for production transferred to the next department; on a test basis recompute unit costs and ascertain that costs for units lost in process are properly reallocated to surviving units.	_____	_____	_____
c. Trace materials costs charged to the selected departments to appropriate journals and on a test basis to individual requisitions.	_____	_____	_____
d. Trace labor costs incurred to account distribution analyses of the payroll registers.	_____	_____	_____
e. Review the allocation of overhead.	_____	_____	_____
7. Evaluate internal control structure for costs of sales and inventory and:			
a. Record the matters considered and conclusions reached in making the evaluation in accordance with firm policy (completion of questionnaires, checklists, preparation of required memoranda, etc.).	_____	_____	_____
b. Based on the evaluation, make necessary modifications to applicable sections of the program for substantive tests.	_____	_____	_____
c. Identify and note reportable conditions in internal control structure to be brought to the client's attention (SAS No. 55 [AU section 319]).	_____	_____	_____
d. Identify and note other internal control structure matters to be brought to the client's attention.	_____	_____	_____

This audit program section has been completed in accordance with firm policy.

Date

Done by

Reviewed by

	Done By	Date	W/P Ref.
<b>III. Cash</b>			
<b>A. .160 Cash—Audit Objectives</b>			
1. To determine that:			
a. Cash exists and is owned by the entity.	_____	_____	_____
b. Cash balances reflect a proper cutoff of cash receipts and disbursements.	_____	_____	_____
c. Cash balances as presented in the balance sheet properly reflect all cash and cash items on hand, in transit, or on deposit with third parties.	_____	_____	_____
d. Cash balances are properly classified in the financial statements and any restrictions on the availability of funds are properly disclosed.	_____	_____	_____
<b>B. .170 Cash in Banks—Substantive Test Procedures</b>			
1. Confirm bank balances (using standard bank confirmation forms) as of the balance sheet date for all banks used during the year.	_____	_____	_____
2. Arrange to obtain cutoff bank statements and related paid checks directly from the banks for . . . days following the balance sheet date.	_____	_____	_____
3. Obtain or prepare a comparative listing of the component bank account and petty cash fund balances as of the closing and opening balance sheet dates for the year (period) being audited:			
a. Refoot the schedule and trace totals to the financial statement assembly sheets.	_____	_____	_____
b. Trace closing balances to the general ledger and working papers on bank reconciliations and petty cash funds.	_____	_____	_____
c. Trace opening balances to the working papers for the preceding audit.	_____	_____	_____
d. For bank accounts opened and closed during the year (period) trace to authorization in the minutes of the board of directors meetings.	_____	_____	_____
4. Obtain copies of the bank reconciliations as of the balance sheet date and perform the following:			
a. Trace the book balance to the balance per the general ledger control account and to the working lead schedule or trial balance.	_____	_____	_____
b. Compare the bank balance to the cutoff bank statement and to the bank confirmation.	_____	_____	_____
c. Test the clerical accuracy of the reconciliation.	_____	_____	_____
d. Review and explain unusual reconciling items and trace to appropriate subsequent disposition.	_____	_____	_____
e. Trace deposits in transit to the cutoff bank statement(s) and ascertain whether the time lag is reasonable.	_____	_____	_____
f. Inspect selected paid checks returned with the cut-off bank statement. Examine first cancellation date on the paid checks to identify any checks that were not recorded in the period under audit. Trace checks drawn prior to the end of the period under audit to the list of outstanding checks and to the cash disbursements journal as to date, payee, and amount.	_____	_____	_____
g. List and investigate any unusual checks including checks drawn to "bearer" or "cash."	_____	_____	_____
h. List and investigate any outstanding checks of \$ . . . or over which did not clear the banks within a reasonable period to ascertain that the disbursements are proper.	_____	_____	_____
5. Obtain or prepare an analysis of cash in savings banks and cash invested in certificates of deposit including identity of the individual banks and accounts or certificates, interest rates, maturities for certificates of deposit, opening and closing balances, activity during the year, and related interest income accrued and collected; perform the following:			
a. Trace book balances and related income to the general ledger control account.	_____	_____	_____
b. Test the footings and crossfootings.	_____	_____	_____

	Done By	Date	W/P Ref.
c. Obtain confirmations from the bank of balances at the close of the year (or period), related interest rates and methods of computation and amounts.	_____	_____	_____
d. Examine passbooks and certificates of deposit, comparing them to bank confirmation; be alert for unrecorded passbook transactions or substituted certificates.	_____	_____	_____
e. Recompute (all or on a test basis) amounts of interest earned and trace amounts to the related income accounts.	_____	_____	_____
6. Prepare a bank transfer schedule providing column headings for the following:			
a. Name of disbursing bank	_____	_____	_____
b. Check number or other reference	_____	_____	_____
c. Amount	_____	_____	_____
d. Date disbursed per books	_____	_____	_____
e. Date disbursed per bank	_____	_____	_____
f. Name of receiving bank	_____	_____	_____
g. Date deposited per books	_____	_____	_____
h. Date deposited per bank	_____	_____	_____
i. Perform the following:			
(1) Review the cash receipts and disbursements journals, bank statements and related paid checks (including the cutoff bank statements) for the last . . . days before and first . . . days after the closing date of the year (period) and list all bank transfers (or each transfer of \$ . . . or over) on the transfer schedule.	_____	_____	_____
(2) Review the schedule to determine that the deposit and disbursement side of each transfer is recorded in the proper period and that any time lag between book and bank entries appears reasonable. Trace incompleting transfers to the schedule of outstanding checks and/or deposits in transit.	_____	_____	_____
7. If cutoff statements and related paid checks are not independently received by the auditor (or firm of auditors) directly from the bank, obtain the bank statements and related paid checks for the month following the balance sheet date and perform the following:			
a. Inspect bank statements for erasures and prove arithmetic accuracy of the statements (opening balance plus total deposits and other credits, less the closing balance equals total disbursements and other charges).	_____	_____	_____
b. Examine paid date of each check and debit memo to ascertain it was paid by the bank during the period covered by the bank statements.	_____	_____	_____
c. Foot the paid checks and debit memos to ascertain that the total agrees with total charges per the bank statements.	_____	_____	_____
d. Request banks to confirm the balance at the end of the statement period.	_____	_____	_____
8. On receiving the banks' responses to standard bank confirmation requests:			
a. Ascertain that all of the inquiries have been answered. If any inquiries have not been answered, telephone or correspond with the bank to obtain the missing information (in writing).	_____	_____	_____
b. Trace the bank balances to the copies of applicable bank reconciliations included in the working papers; and accumulate the other responses for use in work on liabilities, commitments and contingencies.	_____	_____	_____
9. Return the cutoff bank statements with related paid checks and other bank memoranda to the client and obtain a receipt.	_____	_____	_____
<b>C. .180 Cash Funds and Petty Cash—Substantive Test Procedures</b>			
1. Identify all funds, including locations, custodians, amounts, and purpose and decide:			

	<u>Done By</u>	<u>Date</u>	<u>W/P Ref.</u>
a. Which funds are to be counted and, if so, whether to count them simultaneously and whether simultaneous control and inspection of other assets, such as negotiable securities, is also necessary.	_____	_____	_____
b. Timing of counts to be at a preliminary date, the balance sheet date or subsequent to the balance sheet date.	_____	_____	_____
2. Count all undeposited cash, petty cash, unclaimed wages, stamps, etc., in the presence of the custodian (A client's representative should be present at all times during the count.) and:			
a. List currency and coins counted by denomination.	_____	_____	_____
b. List other items such as stamps, checks, and vouchers; examine vouchers as to date, amount, payer, authorization, signature, account charged, and documentation. Identify large or unusual amounts for possible follow-up.	_____	_____	_____
c. Trace the fund balance per the count to the balance per the general ledger.	_____	_____	_____
d. List all unusual items such as postdated checks or vouchers prepared in pencil for discussion with a responsible member of the client's staff.	_____	_____	_____
e. If petty cash reimbursement checks are included in the fund, trace the amounts to cash book entries dated prior to the count.	_____	_____	_____
f. Have the custodian sign a receipt at the conclusion of the count.	_____	_____	_____
3. Consider whether to confirm funds at branch offices and other locations which are not scheduled for a physical count.	_____	_____	_____

This audit program section has been completed in accordance with firm policy.

Date

Done by

Reviewed by

Done By	Date	W/P Ref.
------------	------	-------------

**IV. Investments****A. .190 Audit Objectives**

## 1. To determine that:

- |   |       |       |       |
|---|-------|-------|-------|
| a. The entity owns the investments as at the balance sheet date and has physical evidence of ownership (securities, receipts from responsible custodians, etc.).  | _____ | _____ | _____ |
| b. The market or other fair value of the investments has been determined as objectively as practicable.   | _____ | _____ | _____ |
| c. Related income from the investments is properly recorded and received.   | _____ | _____ | _____ |
| d. Restrictions, pledges or liens on any of the investments and related liabilities are identified and adequately disclosed in the financial statements.  | _____ | _____ | _____ |
| e. The financial statement presentation and disclosure of investments and related income (classification, amounts such as cost, market, share of equity) is in conformity with generally accepted accounting principles consistently applied. | _____ | _____ | _____ |

**B. .200 Substantive Test Procedures**

## 1. Were the following items considered:

- |  |       |       |       |
|--|-------|-------|-------|
| a. Results of the tests of controls performed as it relates to investments and related income.   | _____ | _____ | _____ |
| b. Plans for physical inspection, confirmation procedures, or a combination of both, including whether this should be done on a surprise basis, as of the balance sheet date, or both.                                   | _____ | _____ | _____ |
| c. Need for control of investments and simultaneous control of such related items as cash funds and detailed subsidiary records of investments when performing the inspections and confirmation selections and mailings. | _____ | _____ | _____ |
| d. Competent independent sources for market valuation.   | _____ | _____ | _____ |
| e. Competent independent sources for substantiating declaration and remittance of investment income.   | _____ | _____ | _____ |

## 2. Obtain or prepare detailed analyses of investments showing:

- |  |       |       |       |
|--|-------|-------|-------|
| a. Classification between current and non-current portfolios and investments accounted for on the equity method.   | _____ | _____ | _____ |
| b. Description of the security, including any interest rate and maturity of debt, the dividend rate on cumulative preference shares, etc.  | _____ | _____ | _____ |
| c. Number of shares, par value, or face amount held at the end of the preceding period, and the balance at cost and at market or equity, if applicable, together with any unamortized premium or discount on bonds.                | _____ | _____ | _____ |
| d. Additions including date, number of shares, par values or face amounts, and cost.   | _____ | _____ | _____ |
| e. Sales and disposition including date, number of shares, par value or face amounts, cost, proceeds, and realized gain or loss.   | _____ | _____ | _____ |
| f. Number of shares, par values, or face amounts held at the end of the period, and the balance at cost and at market or equity, if applicable, together with any unamortized premium or discount on bonds.                        | _____ | _____ | _____ |
| g. Related valuation allowances at the beginning and the end of the period and changes therein.  | _____ | _____ | _____ |
| h. Investment income (dividends, interest, etc.) for individual investments—accrued at the end of the previous period, earned during the current period, collected during the period and accrued at the end of the current period. | _____ | _____ | _____ |

## 3. Foot and crossfoot the analyses.

## 4. Trace ending totals to the general ledger and financial statement assembly sheets; trace opening balances to the prior period audit working papers.

	<u>Done By</u>	<u>Date</u>	<u>W/P Ref.</u>
5. Inspect securities on hand in the presence of the custodian (including treasury stock and securities held as collateral) at the balance sheet date or at a date shortly before or after, and examine supporting evidence (for example, bank and broker advices) for transactions between the inspection date and balance sheet date.	_____	_____	_____
a. Ascertain that certificates issued in nominee names are owned by the client.	_____	_____	_____
b. Note certificate or serial numbers, if useful.	_____	_____	_____
c. If the investment is in the debt or equity of a nonpublic entity, consider obtaining confirmation from the issuer or trustee.	_____	_____	_____
d. Obtain a signed receipt.	_____	_____	_____
6. Obtain positive confirmation as of the balance sheet date for investments held by independent custodian; consider whether inspection of investments held by custodians is necessary.	_____	_____	_____
7. Examine contractual terms of debt securities and preferred stocks.	_____	_____	_____
8. Determine that sales and purchases were properly approved; trace transactions to minutes of the Board of Directors or Finance Committee meetings.	_____	_____	_____
9. Examine bank or broker's advices and custodian's reports in support of purchases and sales.	_____	_____	_____
10. Determine that gain or loss on disposition of a security has been computed properly.	_____	_____	_____
11. Trace payments for purchases to cancelled checks and proceeds from sales to entries in cash book.	_____	_____	_____
12. By reference to published sources, by computation, and by examination of the cash receipts journal, determine that income from securities has been properly accrued or collected.	_____	_____	_____
13. Determine that the amortization of premium and discount on bonds has been properly computed.	_____	_____	_____
14. Determine that market value for both the current and non-current portfolios has been properly computed. Trace quoted market prices to competent published sources; obtain appraised values of infrequently traded securities.	_____	_____	_____
15. For investments in nonpublic entities and investments carried on the equity method, compare carrying value to information in the most recently available audited financial statements. If necessary, use financial reports and statements issued later than the most recently available audited financial statements.	_____	_____	_____
16. Compute the unrealized gain or loss on both the current and non-current portfolios for marketable equity securities.	_____	_____	_____
17. Determine that the unrealized gain or loss on the current portfolio has been properly classified in the income statement and that the unrealized gain or loss on the non-current portfolio has been properly classified in the equity section of the balance sheet.	_____	_____	_____
18. Determine that all transfers from the current to non-current portfolios have been properly recorded in accordance with management's authorization and note pertinent information for the client representation letter.	_____	_____	_____
19. Determine that any permanent impairment in value has been properly recognized and accounted for.	_____	_____	_____

This audit program section has been completed in accordance with firm policy.

Date

Done by

Reviewed by

Done By	Date	W/P Ref.
------------	------	-------------

1. To determine that:

- |  |  |  |
|--|--|--|
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |

1. Based on the assessed level of risk, decide on the following:

- [illegible]



	Done By	Date	W/P Ref.
c. Trace confirmation replies to the trial balance and investigate replies with differences.	_____	_____	_____
Note: The auditor may prepare a control of exceptions such as copies of replies or a list and arrange for the client's staff to investigate the differences and accumulate supporting documentation for the auditor's review.			
d. Obtain new addresses for all confirmations returned by the post office and remail.	_____	_____	_____
e. Send second requests for all unanswered positive confirmation requests. Consider sending third requests by registered or certified mail, and performing alternative auditing procedures.	_____	_____	_____
f. Perform alternative auditing procedures for unanswered positive confirmation requests.	_____	_____	_____
g. Summarize the results of the confirmation procedures.	_____	_____	_____
h. Subsequent to the confirmation date, consider reviewing the customer's ledger and remittance advices for cash receipts.	_____	_____	_____
6. For positive confirmation requests to which no reply was received, accounts which declined to provide confirmation information and accounts which the client requested not be confirmed:	_____	_____	_____
a. Test items subsequently paid to remittance advices which identify the specific invoices paid.	_____	_____	_____
b. Examine customer's purchase orders, related invoices and shipping documents for amounts that are not supported by remittance advices which identify the specific invoices paid.	_____	_____	_____
c. Establish the existence of the customer by reference to such sources as Dun and Bradstreet Reference Book.	_____	_____	_____
7. If accounts receivable were confirmed as of a date other than the balance sheet date, obtain an analysis of transactions between the confirmation and balance sheet dates, trace amounts to books of original entry, and review the analysis and books for significant unusual entries.	_____	_____	_____
8. Obtain or prepare an analysis of trade notes receivable including the following information:	_____	_____	_____
a. Maker.	_____	_____	_____
b. Date made/date due.	_____	_____	_____
c. Original terms of repayment.	_____	_____	_____
d. Collateral, if any.	_____	_____	_____
e. Interest rate.	_____	_____	_____
f. Balance at the end of last period.	_____	_____	_____
g. Principal—additions, payments.	_____	_____	_____
h. Interest income—at the end of the preceding period, earned during the current period, received during the current period, and accrued at the end of the current period.	_____	_____	_____
(1) Foot schedule and trace totals to applicable general ledger accounts.	_____	_____	_____
(2) Physically inspect all notes in possession of the client.	_____	_____	_____
(3) Request positive confirmation of the terms and balances of notes with makers (as of the balance sheet date or other date). Investigate any differences.	_____	_____	_____
(4) Confirm notes out for collection with collection agents.	_____	_____	_____
(5) Inspect collateral for notes, if any, making sure that items were not included in corresponding asset accounts of the company.	_____	_____	_____

	<u>Done By</u>	<u>Date</u>	<u>W/P Ref.</u>
(6) Recompute interest income, accrued interest and unearned discount; trace interest collections, if any, to the cash receipts journal. Ascertain that computations of interest and recognition of interest income is in conformity with APB Opinion No. 21 [AC section I69].	_____	_____	_____
9. Ascertain whether any accounts or notes have been assigned, pledged or discounted by reference to minutes, review of agreements, confirmation with banks, etc.	_____	_____	_____
10. Ascertain whether any accounts or notes receivable are owed by employees or related parties such as officers, directors, shareholders, and affiliates, and:			
a. Obtain an understanding of the business purpose for the transactions which resulted in the balances.	_____	_____	_____
b. Ascertain that transactions were properly authorized.	_____	_____	_____
c. Obtain positive confirmations of the balances (as of the balance sheet date or some other date) except for intercompany accounts with affiliated companies which the firm is concurrently examining.	_____	_____	_____
d. Determine if any notes repaid prior to the balance sheet date have since been renewed.	_____	_____	_____
11. Obtain or prepare an analysis of the allowance for doubtful accounts for the period, and:			
a. Review accounts written off during the period and determine that significant write-offs have been properly authorized. Examine supporting documentation, including correspondence with the customer. (Such correspondence may indicate a broader problem.)	_____	_____	_____
b. Review adequacy of the allowance and related provision by SAS No. 57, (AU section 342):			
(1) Review the aged trial balance as of the balance sheet date with the client's credit manager or other responsible individual to identify accounts of a doubtful nature and allowances required; review correspondence files and other relevant data in support of client's representations. Items reviewed should include past due amounts and significant amounts whether or not past due.	_____	_____	_____
(2) Examine credit reports for delinquent and large accounts.	_____	_____	_____
(3) Review confirmation exceptions for indication of amounts in dispute.	_____	_____	_____
(4) Consider whether accounts receivable that have been connected to notes receivable pose any unusual credit risk.	_____	_____	_____
(5) Analyze and review trends for the following relationships (SAS No. 56 [AU section 329]):			
(a) Accounts receivable to credit sales.	_____	_____	_____
(b) Allowance for doubtful accounts to accounts receivable (in total and in relation to past due categories per aging analysis).	_____	_____	_____
(c) Sales to returns and allowances.	_____	_____	_____
(d) Expense provisions for doubtful accounts to net credit sales.	_____	_____	_____
(e) Expense provisions for doubtful accounts to write-offs.	_____	_____	_____
(f) Moving average relationship of write-offs to trade receivables.	_____	_____	_____
(g) Average balance per customer	_____	_____	_____
(h) Ratio of accounts receivable to current assets	_____	_____	_____
(i) Ratio of notes receivable to accounts receivable	_____	_____	_____
(j) Ratio of renewed notes to notes receivable	_____	_____	_____
c. Identify differences, if any, between the book and tax basis for the allowance for doubtful accounts and related expense provision; summarize information required for determining income taxes currently payable and deferred.	_____	_____	_____

	<u>Done By</u>	<u>Date</u>	<u>W/P Ref.</u>
d. Review revenue, receivable and cash receipts transactions after the balance sheet date including discounts taken, credits allowed, and write-offs for unusual transactions (especially concerning past due balances and large accounts).	_____	_____	_____

This audit program section has been completed in accordance with firm policy.

\_\_\_\_\_

Date

\_\_\_\_\_

Done by

\_\_\_\_\_

Reviewed by

Done By	Date	W/P Ref.
------------	------	-------------

**VI. Inventories****A. .230 Audit Objectives**

1. To determine that:
  - a. The inventory exists and is the client's property.
  - b. The client has taken reasonable care in determining the physical quantities and identifying the condition (normal, slow moving, obsolete) of its inventory.
  - c. The inventories are summarized and priced with clerical accuracy, and the records have been adjusted to the physical inventory.
  - d. Inventory classifications and carrying amounts are determined and presented in the financial statements in conformity with generally accepted accounting principles consistently applied (for example, assumptions about the cost flow such as FIFO and LIFO, and lower of cost or market considerations).
  - e. Any encumbrances such as pledges or liens are identified and adequately disclosed in the financial statements.

_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

**B. .240 Substantive Test Procedures—General**

1. Were the following items considered:
  - a. Results of the tests of controls performed as they relate to inventories, production costs and cost of sales. (A particularly significant issue is whether accounting controls over inventory transactions and balances are of sufficient strength to allow performing the physical count sooner than the balance sheet date.)
  - b. Timely identification of the locations of the physical inventories and their relative materiality by location.
  - c. Timely review of the client's plans and instructions for taking the physical inventory and accumulating, pricing, and summarizing the results. (For example, will pre-numbered tags be used and accounted for? Will counts be independently checked? Who is responsible for summarizing the physical inventory?)
  - d. Whether involvement of specialists is required (see SAS No. 11 [AU section 336]).
  - e. Need for audit assistants based on timing of counts at various locations, materiality of the amounts involved, and degree of difficulty of the observation.
  - f. Whether any inventory is held by third parties such as public warehouses and consignees and, if so, whether to obtain positive confirmation or because of materiality observe its physical count (see SAS No. 1, section 331.14—.15, as amended by SAS No. 43, paragraph 3 [AU section 331.14]).
  - g. Information to be recorded during observation when noting test counts for subsequent tracing to summarization of the physical inventory.
  - h. Information to be recorded at time of the physical count for subsequent tracing to other records as a cutoff test.

_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

**C. .241 Before Observation of the Physical Inventory**

Note: Some auditing procedures may serve to accomplish the purpose of both tests of controls and substantive tests. Certain steps that are listed here as illustrative substantive tests are also listed among illustrative tests of controls for inventory. They are listed here because they provide evidence with respect to the client's accounting for cost of sales and cost of inventory. They are listed as tests of controls because they may serve to clarify and confirm the auditor's understanding of the internal control structure of inventory and cost of sales.

1. Tour the client's manufacturing or production facilities with a member of the client's organization familiar with production.

_____	_____	_____
-------	-------	-------

	<u>Done By</u>	<u>Date</u>	<u>W/P Ref.</u>
2. On a test basis, select transactions for additions and deletions of inventory from such sources as receiving reports, requisitions to place materials into production, and shipping advices. Note the reference or control number, date, description, quantity, and dollar amount for each transaction selected. Trace the transactions to the perpetual inventory record and the cost accounting records, if any, used to determine unit or job costs. Perform similar tests selecting the transactions from the perpetual inventory records and/or cost accounting records and trace the transactions to receiving reports, requisitions, and shipping advices.	_____	_____	_____
Note: This test may be coordinated with tests of controls for purchases, payables, and disbursements, and for revenues, receivables, and receipts.			
3. Obtain an analysis of overhead costs charged to inventories and over- and under-absorbed overhead. Review the amounts included in the overhead pool for propriety and perform the following:			
a. Determine that overhead costs are being charged to inventory in accordance with an appropriate policy (for example, as a percent of direct labor).	_____	_____	_____
b. Identify disposition of variances, if any, between actual overhead costs incurred and overhead costs applied to production and inventory. Determine that variances are reasonable. Determine that no excessive costs for idle plant are being charged to inventory.	_____	_____	_____
4. If a job order cost system is used, obtain the job order ledger (or tabulation), select a period(s) and perform the following:			
a. Trace total costs incurred to the voucher register (or cash disbursements journal), the payroll distribution, and support for overhead applied.	_____	_____	_____
b. Test the footings of the job order ledger by refooting the detail for selected subtotals and refooting the subtotals.	_____	_____	_____
c. Select . . . job orders for jobs in process and completed jobs and perform the following:			
(1) Examine authorization for the job order.	_____	_____	_____
(2) Trace materials used on a test basis at various times since inception of the job order to such supporting details as requisitions, purchase orders, receiving reports, and processed invoices. (Consider coordination with tests of controls for purchases.)	_____	_____	_____
(3) Trace direct labor costs to account distributions of the payroll registers and on a test basis to individual time reports or time cards. (Consider coordination with tests of controls for payroll.)	_____	_____	_____
(4) Trace application of overhead costs to analyses used to accumulate overhead costs; test computations and review for reasonableness.	_____	_____	_____
(5) Identify the status of the job (work in process, finished goods, or goods shipped) and trace through necessary summarization to the applicable general ledger account. Obtain explanation for any unreasonable time lag between completion and shipping dates for job orders performed for specific customers.	_____	_____	_____
5. For process cost systems, obtain the cost of production reports for each department within the production process for a selected period(s) and:			
a. Trace quantities and dollar amounts for units received for selected departments to the quantities and dollar amounts transferred out per the preceding department in the sequence of production.	_____	_____	_____
b. For each selected department, review the computations of total and unit costs for production transferred to the next department; on a test basis recompute unit costs; and ascertain that costs for units lost in process are properly reallocated to surviving units.	_____	_____	_____
c. Trace materials costs charged to the selected departments to appropriate journals and on a test basis to individual requisitions.	_____	_____	_____
d. Trace labor costs incurred to account distribution analyses of the payroll registers.	_____	_____	_____

	Done By	Date	W/P Ref.
e. Review the allocation of overhead.			
<b>D. .242 Observation of the Physical Inventory</b>			
1. Include the following in advance planning:			
a. Review and evaluate the adequacy of the client's instructions for making the physical count.			
b. Consider attending the client's preparatory meetings for the physical count.			
c. If a specialist is to be involved, review and evaluate the professional qualifications and reputation of the specialist; obtain an understanding of the nature of the work to be performed by the specialist.			
d. Determine the nature and timing of confirmation requests needed from custodians of inventory such as public warehouses and consignees.			
e. Review adequacy of audit staffing arrangements.			
2. Tour the premises on arrival and ascertain whether the inventory arrangement is conducive to a satisfactory count; if the arrangement appears obviously unsatisfactory, recommend rearrangement.			
3. Ascertain that items on hand which are not property of the client are clearly identified, segregated, and excluded from the count. Note such references as descriptions, quantities, serial numbers, and shipping advice numbers so that in subsequent tests of inventory summarization the auditor may determine whether the items were excluded from the physical count.			
4. Visit the shipping and receiving departments and record the control numbers for the last shipping advice and receiving report prepared prior to the physical count for subsequent tracing to accounting department records. Consider recording a few additional shipping advice and receiving report numbers for subsequent tracing.			
5. Ascertain that receiving and shipping departments are informed that receipts after and shipments before the inventory cutoff are to be excluded from the count. Ascertain that receiving reports for items not included in the count are prominently marked "after inventory."			
6. Observe and note client's provision for segregation and/or clear identification of slow-moving, obsolete and/or damaged items; also be alert for such items among regular stock and, if present, bring to the client's attention and note for subsequent consideration.			
7. Inspect representative items of inventory and ascertain the source of their identification, description, status (work-in-process, finished goods, etc.), basis for count or measure (volume, weight, item tally, etc.). Inquire of both production personnel and personnel involved in the count about such items.			
8. Observe and ascertain that the client's inventory instructions and procedures are being followed.			
9. Ascertain that pre-numbered inventory tickets on count sheets are properly controlled including:			
a. Accounting for all tickets or sheets issued to count personnel.			
b. Accounting for return of all tickets or sheets issued including those unused and spoiled as well as those used, at completion of the inventory.			
c. Note series of tickets or count sheet numbers used and those unused or spoiled for subsequent tracing in tests of summarization.			
10. Observe the count process and make test counts ascertaining that the identifications, descriptions, and quantities are being properly noted on the inventory tickets or count sheets. If inventory count sheets are used, select some items from the floor, make test counts and trace them to the sheets; select some entries from the sheets (include some items of greater dollar value) and trace them to items on the floor.			

	<u>Done By</u>	<u>Date</u>	<u>W/P Ref.</u>
11. Prepare a worksheet listing some items (include some items of greater dollar value) test counted, for subsequent tracing into the client's inventory summarization. Include on the worksheet for each item the inventory ticket or count sheet number, location, description, quantity per client, quantity per your test count, and other particulars essential for subsequent tracing to the inventory summarization. Bring test count differences to the client's attention during the count so they may be resolved in a timely manner. If test count differences are not isolated, it may be necessary to request a recount of a particular area or department.	_____	_____	_____
12. Observe that all items of inventory are clearly ticketed or marked when counted to avoid omissions and/or duplications of counts.	_____	_____	_____
13. Observe whether any items are not being counted and obtain an adequate explanation for their omission.	_____	_____	_____
14. Note any movement of inventory during the count; obtain an explanation for the movement and record details from the applicable authorizing documents for consideration in review of the cutoff.	_____	_____	_____
15. Prepare a memorandum on the observation of the physical inventory including:			
a. Comment on the physical inventory arrangements.	_____	_____	_____
b. Implementation of the client's inventory instructions.	_____	_____	_____
<b>E. .243 Summarization—Physical Quantities</b>			
1. Relate and trace information, noted during observations of the physical, about control numbers for count tickets or count sheets used, to the client's summarization of the physical for reasonable assurance that only tickets or sheets used for the physical are included in the summarization of quantities. (Summarization of quantities may consist of the quantities per the final priced inventory or an intermediate tabulation of count tickets. In some instances the original count sheets may provide for entry of prices, extensions, and summarization of dollar amounts.)	_____	_____	_____
2. Trace test counts noted during the physical to the client's summarization of quantities.	_____	_____	_____
3. Trace quantities confirmed by third parties to the summarization of quantities.	_____	_____	_____
4. Depending on the extent of the work in step 2 above and on the internal control structure over inventory summarization, select quantities for particular items from the summarization and trace them to the count tickets or count sheets; select quantities for particular items from the count tickets or sheets and trace them to the summarization of quantities.	_____	_____	_____
5. If the client uses perpetual inventory records and the perpetuals are to be used to determine the year-end balance, trace items on a test basis to and from the physical inventory summaries; ascertain that the perpetuals were adjusted to the physical.	_____	_____	_____
6. Trace notes made at the observation for slow-moving, obsolete, and/or damaged items to the client's summarization of quantities and determine if they are clearly identified as such.	_____	_____	_____
7. Test the cutoff information noted at the observation of the physical inventory as follows:			
a. Select the last few shipping advices used before the count to the sales register; determine that the shipments were recorded as sales and charges to cost of sales at the dates shipped.	_____	_____	_____
b. Select a few shipping advices used after the count to the sales register and determine that the shipments were recorded as sales in the period after the date of the inventory.	_____	_____	_____
c. Select the last few receiving reports used before the count and determine that the related liability was recorded prior to or as of the count date.	_____	_____	_____

	<u>Done By</u>	<u>Date</u>	<u>W/P Ref.</u>
8. If the client uses a process cost system, trace selected quantities per the physical inventory to the departmental cost of production reports and determine that quantities have been adjusted to the physical inventory as of the date of the physical count.	_____	_____	_____
<b>F. .244 Prices and Summarization—Monetary Units</b>			
1. Ascertain the methods followed concerning the flow of costs (FIFO, LIFO, moving average, etc.) and compare with working papers of the preceding year to ascertain whether the methods have been consistently applied.	_____	_____	_____
2. For purchased materials and supplies included in inventory, trace unit costs to prices per recent vendors' invoices and/or to prior year inventory if LIFO is used. Note dates per vendors' invoices and be alert for slow-moving items. Ordinarily, sufficient invoices should be inspected to cover the quantities on hand.	_____	_____	_____
3. Trace unit costs per the physical inventory of work-in-process and finished goods, on a test basis, to the cost accounting records and perform the following:			
a. Obtain and review trial balances or tabulations of detailed components of production costs incurred for the year (period) and compare with the equivalent for the preceding year (period).	_____	_____	_____
(1) Obtain and note explanations for apparent inconsistencies in classification and significant fluctuations in amounts.	_____	_____	_____
(2) Ascertain that the cost classifications accumulated as production costs and absorbed in inventory are in conformity with generally accepted accounting principles.	_____	_____	_____
b. Review computations of unit costs and costs credited against inventory and charged to cost of sales; update findings from tests made prior to observation of the physical count, and consider the need for further detail tests.	_____	_____	_____
c. Review activity in the general ledger control accounts for raw materials, supplies, work-in-process, and finished goods inventories; investigate any significant unusual entries or fluctuations.	_____	_____	_____
d. Review labor and overhead allocations to inventory and cost of sales; compare to actual labor and overhead costs incurred and ascertain that variances appear reasonable in amount and have been properly accounted for.	_____	_____	_____
4. Perform the following tests for clerical accuracy of the summarized physical inventory:			
a. Recompute extensions of quantities and unit costs on a test basis.	_____	_____	_____
b. Refoot accumulation of dollar subtotals on a test basis.	_____	_____	_____
c. Refoot dollar subtotals to test total dollar amounts per the physical inventory for the major classifications (i.e., raw materials, work-in-process, finished goods, supplies, etc.).	_____	_____	_____
d. Review the inventory listings for significant quantities and amounts that appear unusual.	_____	_____	_____
e. Ascertain that the general ledger control accounts have been adjusted to include the findings of the physical inventory. (This may consist of tracing the totals per the physical to an analysis which supports journal entries, or an involved trail of tracing through the cost accounting records to the general ledger control accounts.)	_____	_____	_____
5. Review the pricing, extensions, and summarization of the physical inventory for items identified as slow-moving, damaged, and/or obsolete to ascertain that the items are carried at dollar amounts in conformity with the lower of cost or market principle:			
a. Examine documentation for the proceeds of recent scrap or salvage sales.	_____	_____	_____
b. Review client's criteria for considering items as slow-moving or obsolete and evaluate whether criteria appear reasonable and realistic. (For example, are a certain number of months used to determine when an item becomes slow-moving? Are predetermined quantities used to determine that quantities on hand are not in excess of reasonable economic need?)	_____	_____	_____



	<u>Done By</u>	<u>Date</u>	<u>W/P Ref.</u>
<b>G. .245 Lower of Cost or Market Considerations</b>			
1. On a test basis select items of raw materials and supplies inventory including some items with relatively significant carrying amounts (because of high unit costs or large quantities on hand) and:			
a. Compare the inventory unit prices with prices per recent vendors' invoices, vendor quotations, vendor price lists, and published market quotations.	_____	_____	_____
b. Review purchase records and production requisitions for indications of whether items may be on hand in excess quantities, slow-moving, or obsolete.	_____	_____	_____
2. On a test basis select items or classifications of finished goods and work-in-process inventories including some items with relatively significant carrying amounts (because of high unit costs or large quantities on hand) and:			
a. Review and note current selling prices and quantities sold for the items or classifications by reference to recent sales invoices, customer orders, and published market quotations, and supplementary discussion with the client's marketing and sales executives.	_____	_____	_____
b. Compare inventory carrying amounts and recent selling prices for the selected finished goods items or classifications noted in terms of current relationships of sales to gross profit, selling and shipping expenses; ascertain that the carrying amounts of the selected finished goods items are not in excess of net realizable value.	_____	_____	_____
c. For the selected work-in-process items, ascertain their stage of completion and estimated cost to complete by reference to the cost accounting records, production reports, and inquiry of the client's production supervisors. Apply the estimated costs to complete to the selected work-in-process items and apply steps a and b above.	_____	_____	_____
d. Compare quantities on hand for selected items with quantities noted per recent sales invoices and customer orders; be alert that quantities on hand are not in excess of the client's requirements.	_____	_____	_____
3. Compute the following ratios, compare them with similar ratios for prior years, and obtain explanations for unusual fluctuations:			
a. Inventory turnover (cost of sales % inventory)	_____	_____	_____
b. Gross profit percentage (net sales % gross profit)	_____	_____	_____
4. Compare inventory balances as at the end of the year (period) with balances as at the beginning of the year (period) and obtain explanations for significant and unusual fluctuations (SAS No. 56 [AU Section 329]).	_____	_____	_____
5. Relate inventory balances as at the end of the year (period) to anticipated future sales.	_____	_____	_____
<b>H. .246 Other</b>			
1. If the physical count was not taken as of the balance sheet date, analyze and reconcile the balance per the physically counted inventory to inventory per the balance sheet:			
a. Review and analyze the general ledger control accounts for inventory from the date counted to the balance sheet date; trace additions to such sources as the purchase journal or voucher register, the cost accounting records, and charges to cost of sales.	_____	_____	_____
b. Compare the current activity between the count date and balance sheet date to activity of the equivalent period in the preceding year. Investigate unusual fluctuations (SAS No. 56 [AU section 329]).	_____	_____	_____
2. Perform the following analytical procedures:			
a. Compare inventory balances to purchases, sales, and production reports.	_____	_____	_____
b. Analyze raw materials turnover, raw materials issued to raw materials inventory.	_____	_____	_____
c. Review the ratio of material, labor, and overhead to total cost.	_____	_____	_____
d. Analyze changes in gross profit.	_____	_____	_____

	<u>Done By</u>	<u>Date</u>	<u>W/P Ref.</u>
e. If there were sales of scrap material, review standard cost scrap factor by the pounds processed by the published price and determine reasonableness of the scrap income.	_____	_____	_____
3. Review the sales journal and investigate the authenticity of any unusually large sales made in the period prior to the inventory count date.	_____	_____	_____
4. Determine whether any inventory is pledged as collateral or subject to any liens; coordinate with work on debt payable.	_____	_____	_____
5. Inspect open purchase order file at the balance sheet date for significant commitments that should be considered for disclosure.	_____	_____	_____

This audit program section has been completed in accordance with firm policy.

Date

\_\_\_\_\_  
Done by

\_\_\_\_\_  
Reviewed by

	Done By	Date	W/P Ref.
<b>VII. Property and Equipment, and Related Depreciation</b>			
<b>A. .250 Audit Objectives</b>			
1. To determine that:			
a. The property exists and is owned by the entity.	_____	_____	_____
b. Additions to property are authentic, recorded at cost, and properly distinguished from maintenance and repairs expense.	_____	_____	_____
c. Retirements of property together with the proceeds from salvage and related cost to remove are properly recognized.	_____	_____	_____
d. A proper amount of depreciation expense is allocated to the period based on the asset cost, estimated life and salvage, and use of acceptable methods consistently applied, and adequately presented in the financial statements.	_____	_____	_____
e. The net carrying value as presented in the financial statements is expected to be recoverable through the ordinary course of business.	_____	_____	_____
f. Any encumbrances and liens are identified and adequately disclosed in the financial statements.	_____	_____	_____
g. Significant amounts of idle property and equipment are properly stated, classified and described.	_____	_____	_____
h. Significant amounts of fully depreciated assets are considered for disclosure.	_____	_____	_____
<b>B. .260 Substantive Test Procedures</b>			
1. Obtain (or update) an understanding of the client's policies concerning capitalization of assets and related depreciation methods and depreciable lives.	_____	_____	_____
2. Consider a tour of the client's facilities for new staff assigned to the engagement, or for the entire audit team if significant changes have occurred.	_____	_____	_____
3. Consider the extent to which it may be practicable to perform substantive tests prior to the balance sheet date.	_____	_____	_____
4. Obtain or prepare the following schedules:			
a. Summary schedule of property, plant and equipment, and related depreciation (by major asset classification) including the following:			
(1) Beginning and ending asset balances at cost.	_____	_____	_____
(2) Asset additions at cost.	_____	_____	_____
(3) Asset retirements and dispositions.	_____	_____	_____
(4) Other changes.	_____	_____	_____
(5) Depreciation method and life.	_____	_____	_____
(6) Beginning and ending balances of the allowances for depreciation.	_____	_____	_____
(7) Additions to the allowances for depreciation accompanied by an analysis of amounts expensed, absorbed in inventory, and capitalized.	_____	_____	_____
(8) Reductions of the allowances for depreciation for retirements and dispositions.	_____	_____	_____
b. Additions at cost showing the description, date acquired, transaction reference (purchase order number, check number, work order number, etc.), estimated useful life, and cost for all additions of \$ . . . or over. (Also see step 14 below.)	_____	_____	_____
c. Retirements and dispositions showing the description, date of acquisition, date of retirement or disposition, cost, accumulated depreciation, net carrying value, proceeds of disposition, and gain or loss on disposition. (Also see step 14 below.)	_____	_____	_____
d. Analysis of maintenance expense showing each transaction of \$ . . . or greater (or all transactions) for the year or period.	_____	_____	_____
5. Trace opening balances per the summary schedules to closing balances per the prior year's working papers.	_____	_____	_____

	Done By	Date	W/P Ref.
6. Trace amounts per the summary schedule to the general ledger, the detailed asset records, and to the schedules of additions, and retirements and dispositions; recompute the footings and crossfootings of the schedules.	_____	_____	_____
7. Perform the following tests of selected additions:			
a. Determine the addition has been authorized by reference to such sources as minutes of the meetings of the Board of Directors or Finance Committee and/or capital asset budgets reviewed by the Board of Directors or Finance Committee or by evidence of approval by appropriate, responsible personnel, in accordance with prescribed policies.	_____	_____	_____
b. Examine such supporting documents as purchase contracts, paid checks, vendors' invoices, purchase orders, receiving reports, work orders, engineers' reports, etc.	_____	_____	_____
c. Trace transactions to appropriate entries in the detailed property records.	_____	_____	_____
d. For construction in progress examine supporting work orders, documentation in support of costs incurred such as contractors' invoices, reports and correspondence from engineers and/or architects regarding completion and trace transfers from the construction in progress accounts to other property accounts.	_____	_____	_____
e. Physically inspect selected (or all) major additions.	_____	_____	_____
f. Inquire about related dispositions.	_____	_____	_____
g. Determine whether additions conform with the company's capitalization policy.	_____	_____	_____
h. Determine that installment purchases, if any, are properly recorded.	_____	_____	_____
i. By reference to purchase contracts and contractors' billings identify related liabilities to be recorded in connection with debt or other payables.	_____	_____	_____
8. Perform the following tests of dispositions:			
a. Determine that disposition has been properly authorized.	_____	_____	_____
b. Examine such supporting documents as bills of sale, contracts, delivery memoranda, etc.	_____	_____	_____
c. Trace retirements to the detailed property records.	_____	_____	_____
d. Determine that deductions from the asset accounts and related accumulated depreciation are correct.	_____	_____	_____
e. Determine that gain or loss on disposition has been correctly classified and recorded.	_____	_____	_____
9. For fully depreciated assets, determine whether the assets are still used not retired from service.	_____	_____	_____
10. Determine that assets retired from service, if material, have been removed from the property, plant, and equipment accounts and related accumulated depreciation accounts, and are carried at amounts which are not in excess of realizable value.	_____	_____	_____
11. Review lease agreements for new leases and determine whether leased assets which should be capitalized have been capitalized, and that related depreciation is being determined using an appropriate method and life.	_____	_____	_____
12. Review provisions for depreciation and amortization and:			
a. Determine whether the methods and depreciable lives used in the current year are consistent with the preceding year and are reasonable.	_____	_____	_____
b. Test computations of depreciation and amortization.	_____	_____	_____
c. Determine that amounts of depreciation capitalized in construction in progress are reasonable and appropriate.	_____	_____	_____
d. Ascertain that obsolescence, if any, is being properly recognized by adjustment of depreciable lives.	_____	_____	_____
e. Trace additions to the depreciation allowances to the applicable general ledger expense accounts.	_____	_____	_____

	<u>Done By</u>	<u>Date</u>	<u>W/P Ref.</u>
13. Review maintenance expense and examine supporting documentation for selected transactions to determine that the amounts have been properly classified.	_____	_____	_____
14. Obtain or prepare and test an analysis of qualified additions and early dispositions of qualified property in a format which provides for determination of the investment tax credit. (This may be incorporated into schedules for additions and dispositions.)	_____	_____	_____
15. Review the following relationships for the current and preceding year and obtain explanations for significant fluctuations (SAS No. 56 [AU section 329]):			
a. Dispositions of property and equipment to replacements.	_____	_____	_____
b. Accumulated depreciation to plant and equipment balances at cost.	_____	_____	_____
c. Current year depreciation and amortization to plant and equipment balances at cost.	_____	_____	_____

This audit program section has been completed in accordance with firm policy.

Date

\_\_\_\_\_  
Done by

\_\_\_\_\_  
Reviewed by

**AAM § 5400.280**

	<u>Done By</u>	<u>Date</u>	<u>W/P Ref.</u>
9. For property taxes, where significant, obtain or prepare an analysis which relates both prepayments and accruals as of the beginning and end of the period with tax expense. Examine tax billings and determine whether the timing of the period covered by the tax and the payment due dates result in a prepayment or an accrual as of the balance sheet date. Trace charges to expense to the proper expense account.	_____	_____	_____
10. For intangible assets:			
a. Trace authorization for major transactions to minutes of Board of Directors meetings.	_____	_____	_____
b. Examine supporting documents.	_____	_____	_____
c. Ascertain whether amortization has been properly computed in conformity with generally accepted accounting principles, and trace charges to related expense accounts.	_____	_____	_____
11. Determine that there has been no permanent impairment of value for prepaid expenses, deferred charges, intangible assets, etc.	_____	_____	_____
12. Determine that balances are properly classified in the balance sheet (current v. non-current, etc.).	_____	_____	_____
This audit program section has been completed in accordance with firm policy.			
		Date	
Done by _____	_____		
Reviewed by _____	_____		

Done By	Date	W/P Ref.
------------	------	-------------

1. To determine that:

- |  |  |  |
|--|--|--|
|  |  |  |
|  |  |  |
|  |  |  |
|  |  |  |

1. Were the following items considered:

- (3) Investigate and reconcile differences.

_____	_____	_____
_____	_____	_____

\_\_\_\_\_

© 2006 The Authors  
Journal compilation © 2006 Blackwell Publishing Ltd

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

Year	1990	1995	2000
1990	1990	1995	2000

\_\_\_\_\_

Year	Number of cases	Rate per 100,000
1990	1,200	1.2
1991	1,300	1.3
1992	1,400	1.4
1993	1,500	1.5
1994	1,600	1.6
1995	1,700	1.7
1996	1,800	1.8
1997	1,900	1.9
1998	2,000	2.0
1999	2,100	2.1
2000	2,200	2.2
2001	2,300	2.3
2002	2,400	2.4
2003	2,500	2.5
2004	2,600	2.6
2005	2,700	2.7
2006	2,800	2.8
2007	2,900	2.9
2008	3,000	3.0
2009	3,100	3.1
2010	3,200	3.2
2011	3,300	3.3
2012	3,400	3.4
2013	3,500	3.5
2014	3,600	3.6
2015	3,700	3.7
2016	3,800	3.8
2017	3,900	3.9
2018	4,000	4.0
2019	4,100	4.1
2020	4,200	4.2

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_



	<u>Done By</u>	<u>Date</u>	<u>W/P Ref.</u>
5. Test selected unconfirmed balances by examination of vouchers, invoices, and receiving reports.	_____	_____	_____
6. Perform a search for unrecorded liabilities for the period after the close of the year or period under audit to a date on or near the conclusion of fieldwork, including the following sources, and schedule findings to show effect of the potential adjustment on operations or financial position:			
a. Examine files of receiving reports unmatched with vendors' invoices, searching for significant items received on or before the balance sheet date. Use this information to test client's schedule of goods received but not billed. (If vendors' invoices are not available, refer to the purchase order for prices.)	_____	_____	_____
b. Inspect files of unprocessed invoices and vendors' statements for unrecorded liabilities.	_____	_____	_____
c. Review the cash disbursements journal for disbursements after the balance sheet date; obtain and examine supporting detail for each disbursement of \$. . . and over and determine that accounts payable as at the balance sheet date were properly recorded.	_____	_____	_____
d. Review the voucher register for transactions recorded after the balance sheet date; obtain and examine supporting detail for each transaction of \$. . . and over to identify items that should have been recorded at the balance sheet date and were not.	_____	_____	_____
e. Inquire of responsible client staff about their knowledge of additional sources of unprocessed invoices, unrecorded commitments, or contingent liabilities.	_____	_____	_____
7. Liabilities for payroll taxes withheld:			
a. Trace liabilities to payments made subsequent to the balance sheet date; examine the payroll tax deposit receipts.	_____	_____	_____
b. Compare liability to accrued payroll taxes for reasonableness.	_____	_____	_____
c. Trace liabilities to summaries of the applicable payroll registers.	_____	_____	_____

This audit program section has been completed in accordance with firm policy.

Date

Done by

Reviewed by

Done By	Date	W/P Ref.
------------	------	-------------

## X. Accrued Liabilities Other Than Income Taxes

### A. .310 Audit Objectives

1. To determine that:
  - a. Expense accounts include costs and expense applicable to the period.
  - b. All contingencies and estimated future expenses that should be accrued in the period have been accrued, classified and described in accordance with generally accepted accounting principles consistently applied.

### B .320 Substantive Test Procedures

1. Were the following items considered:
  - a. Results of the tests of controls as they relate to purchases, payables and disbursements, and payroll.
  - b. Coordination of work with review and comparisons of costs and expenses incurred for the current year (period) with the preceding year (period) and with budgeted amounts.
2. Obtain or prepare analysis of accrued liability accounts.
3. Examine documents or working papers supporting amounts accrued and:
  - a. Determine the basis and method of accrual
  - b. Recompute amounts provided
  - c. Review accrual for reasonableness
4. Trace amounts accrued during the year to related expense accounts.
5. Compare accrual to subsequent payments, where possible, to determine reasonableness.
6. Determine if any other accruals are required as a result of the search for unrecorded liabilities.
7. Investigate and explain any large fluctuations in accruals between the current and the preceding period (SAS No. 56 [AU section 329]).
8. For vacation accruals:
  - a. Examine union contracts and/or personnel manuals to determine vacation policies.
  - b. Test the client's computation of accrued vacation pay. (In some cases this might be a detailed calculation; in other cases, it may be more in the nature of an overall estimate (SAS No. 57 [AU section 342]).
9. For accrued payroll taxes:
  - a. Compare accruals as of the balance sheet date to subsequent payments and determine that amounts were accrued in the proper period.
  - b. Consider reconciling wages per the payroll tax returns to the payroll registers.

This audit program section has been completed in accordance with firm policy.

Date

Done by

Reviewed by

	<u>Done By</u>	<u>Date</u>	<u>W/P Ref.</u>
<b>XI. Income Taxes Accrued and Provided</b>			
<b>A. .330 Audit Objectives</b>			
1. To determine that:			
a. The provision for income taxes is reasonable.	_____	_____	_____
b. The liability for accrued income taxes is adequate and not excessive in relation to amounts reasonably expected to be payable.	_____	_____	_____
c. Deferred income taxes represent the effect of timing differences.	_____	_____	_____
d. Income tax provisions, accruals and deferrals are properly described and classified in conformity with generally accepted accounting principles consistently applied.	_____	_____	_____
<b>B. .340 Substantive Test Procedures</b>			
1. Was the following considered:			
a. Carefully planned schedules and analyses for the audit working papers may also aid in accumulating information for income tax return preparation.	_____	_____	_____
2. Obtain or prepare analyses of the various current and deferred income tax liabilities and receivables and related provisions showing:			
a. Balances at the beginning of the year (period).	_____	_____	_____
b. Amounts provided.	_____	_____	_____
c. Refunds received.	_____	_____	_____
d. Payments made, indicating date and nature.	_____	_____	_____
e. Balances at the end of the year (period).	_____	_____	_____
3. Trace payments to cash books and general ledger; examine cancelled checks for evidence of timely payment.	_____	_____	_____
4. Compare payments and refunds to copies of income tax returns.	_____	_____	_____
5. Ascertain latest year that income tax returns have been examined and which periods, if any, are being contested. Examine recent Revenue Agent Reports; determine that adequate consideration has been given to items challenged in the past.	_____	_____	_____
6. Determine that any assessments for tax deficiencies and related interest expenses have been properly recorded.	_____	_____	_____
7. Schedule temporary differences and permanent differences between income before taxes for financial reporting purposes and current income tax purposes; review and recompute the current and deferred income tax provisions for the year (period).	_____	_____	_____
8. Determine that tax liability at the balance sheet date is adequate and not excessive.	_____	_____	_____
9. Reconcile the provision for income taxes and the tax liability.	_____	_____	_____
10. Update carryforward analyses of the composition of all income tax liability accounts.	_____	_____	_____
11. Update carryforward analyses of the composition of all deferred tax accounts.	_____	_____	_____
This audit program section has been completed in accordance with firm policy.			
		Date	
<hr/>			
Done by	_____		
<hr/>			
Reviewed by	_____		

**AAM \$ 5400.360**

	<u>Done By</u>	<u>Date</u>	<u>W/P Ref.</u>
8. Recompute interest expense and amortization of debt discount or premium.	_____	_____	_____
9. Reconcile interest expense with debt outstanding during the year (period).	_____	_____	_____
10. Review subsequent payment or renewal of substantial notes.	_____	_____	_____
11. Account for all unissued bonds.	_____	_____	_____

This audit program section has been completed in accordance with firm policy.

Date

\_\_\_\_\_  
Done by

\_\_\_\_\_  
Reviewed by

	Done By	Date	W/P Ref.
<b>XIII. Stockholders' Equity</b>			
<b>A. .370 Audit Objectives</b>			
1. To determine that:			
a. All transactions and commitments (options, warrants, rights, etc.) are properly authorized and classified.	_____	_____	_____
b. All transactions and commitments are recorded at correct amounts in the proper period.	_____	_____	_____
c. All transactions and balances are presented in the financial statements in conformity with generally accepted accounting principles consistently applied and accompanied by adequate disclosures.	_____	_____	_____
<b>B. .380 Capital Stock and Additional Paid-In Capital—Substantive Test Procedures</b>			
1. For each class of stock, identify the number of authorized shares, par or stated value, privileges, and restrictions.	_____	_____	_____
2. Obtain or prepare an analysis of the activity in the accounts; trace opening balances to the balance sheet as of the close of the year (period) previously audited.	_____	_____	_____
3. Examine minutes, bylaws, and articles of incorporation for provisions relating to capital stock and support for all changes in the accounts including authorization per minutes of Board of Directors and stockholders meetings, and correspondence from legal counsel.	_____	_____	_____
4. Account for all proceeds from stock issues (including stock issued under stock option and stock purchase plans):			
a. Recompute sales price and applicable proceeds.	_____	_____	_____
b. Determine that proceeds have been properly distributed between capital stock and additional paid-in capital.	_____	_____	_____
5. If company keeps its own stock record books:			
a. Prepare a carryforward schedule showing certificate number, date and to whom issued, number of shares issued, and date of examination.	_____	_____	_____
b. Reconcile schedule to general ledger.	_____	_____	_____
c. Determine that all issued certificates have been accounted for as outstanding or cancelled.	_____	_____	_____
d. Account for all unissued certificates.	_____	_____	_____
e. Examine supporting correspondence for stock transfers.	_____	_____	_____
6. If the company does not keep its own stock record books:			
a. Obtain confirmation of shares outstanding from the registrar and transfer agent.	_____	_____	_____
b. Reconcile confirmation with general ledger accounts.	_____	_____	_____
7. For stock options and stock option plans, trace authorization to the minutes of the Board of Directors meetings, review the plan and the option contracts. Obtain or prepare and test analyses of stock options which include the following information:			
a. For option plans, the date of the plan, number and class of shares reserved for option, method for determining the option price, period during which options may be granted, and identity of persons to whom options may be granted.	_____	_____	_____
b. For options granted, identity of persons to whom granted, date of grant, number of shares under option, option price, option period, number of shares as to which options are exercisable, and the market price and value of shares under option as of the date of grant or measurement (first date on which are known both (1) the number of shares individual is entitled to receive, and (2) the option or purchase price, if any).	_____	_____	_____

	<u>Done By</u>	<u>Date</u>	<u>W/P Ref.</u>
c. For options outstanding, number of shares subject to option at the beginning of the period, activity during the period (additional shares subjected to option, number of shares exercised under options, number of shares associated with options which expired during the period), and number of shares subject to option at the end of the year (period).	_____	_____	_____
8. Identify all stock rights and warrants outstanding as of the balance sheet date including the number of shares involved, period during which exercisable and exercise price; determine that the rights and warrants were authorized.	_____	_____	_____
9. Identify any stock subscriptions receivable, and:			
a. Determine if they were authorized.	_____	_____	_____
b. Obtain confirmation from subscribers.	_____	_____	_____
c. Ascertain that subscriptions receivable are classified as a reduction of stockholders' equity on the balance sheet.	_____	_____	_____
10. Obtain or prepare an analysis of the treasury stock account and:			
a. Inspect the paid checks and other documentation in support of the treasury stock acquisitions.	_____	_____	_____
b. Examine the treasury stock certificates; ascertain that the certificates are in the company's name or endorsed to the company.	_____	_____	_____
c. Reconcile treasury stock to the general ledger.	_____	_____	_____
11. Ascertain amount of dividends in arrears, if any, on cumulative preferred shares.	_____	_____	_____
<b>C. .381 Retained Earnings</b>			
1. Analyze activity during the period; trace the opening balance to the balance sheet as of the end of the year (period) previously audited; trace net income to financial statement assembly sheets, and trace unrealized loss on noncurrent investments to investment working papers.	_____	_____	_____
2. Determine that dividends paid or declared have been authorized by the Board of Directors and:			
a. Examine paid checks and supporting documents for dividends paid (selected checks to shareholders or to a dividend disbursing agent).	_____	_____	_____
b. Recompute amounts of dividends paid and/or payable.	_____	_____	_____
3. Investigate any prior period adjustments and determine if they were made in accordance with FASB Statement No. 16 [AC section A35.101—.103, .106, and .109—.111].	_____	_____	_____
4. Examine supporting documents and authorization for all other transactions in the account, considering conformity with generally accepted accounting principles.	_____	_____	_____
5. Determine amount of restrictions, if any, on retained earnings at end of period which result from loans, other agreements, or state law.	_____	_____	_____

This audit program section has been completed in accordance with firm policy.

Date

Done by

Reviewed by

Done By	Date	W/P Ref.
------------	------	-------------

## XIV. Revenues and Other Income

### A. .390 Audit Objectives

1. To determine that:
  - a. Revenue transactions represent consideration applicable to goods shipped and/or completed services rendered to customers (or clients) in the normal course of business during the year (period).
  - b. Revenue transactions have resulted in collections or bona fide receivables.
  - c. All revenues earned during the year (period) are recorded and included in the financial statements.
  - d. Revenues are properly classified and described in the financial statements and accompanied by adequate disclosure.
  - e. Other income has been properly recognized, classified, and described in the statement of income.
  - f. The income statement is prepared in conformity with generally accepted accounting principles consistently applied.

_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

### B. .400 Substantive Test Procedures

1. Obtain or prepare comparative analysis of sales for the current and preceding year (period) (and budgeted amounts) including gross sales, discounts granted, returns, credits allowed, and net sales. (Consider additional subclassifications such as sales by product line, division, seasons during the year or period, etc.). Obtain explanations for significant or unusual fluctuations from the preceding year (period) and from budgeted amounts (SAS No. 56 [AU section 329]).

Note: Revenue and profit recognition on long-term service contracts, installment sales, and long-term construction contracts are specialized matters which are common to certain industries; see the applicable industry audit guides.

2. Ascertain whether the entity ships goods to be held on consignment by others, and if so:
  - a. Identify the control accounts, procedures, and entities to whom consignment shipments are made.
  - b. Examine consignment agreements.
  - c. Review subsidiary accounts for entities to whom consignment shipments are made; examine supporting detail and ascertain that shipments on consignment are properly recorded.
  - d. Review shipping advices and trace consignment shipments to the applicable subsidiary records and control accounts; ascertain that consignment shipments are correctly classified and recorded.
  - e. Investigate old or significant consignments to determine whether there are any unrecorded sales.
3. Identify amounts of sales to affiliates, obtain an understanding of their business purpose, and note for disclosure and/or tracing to consolidation eliminating entries. Identify amounts of sales to other related parties (see SAS No. 45 [AU section 334]).
4. For sales cut off as of the closing date for the year (period) and/or the date of the physical inventory:
  - a. Select sales invoices for testing from the sales register for several days before and after the year end (or at the physical inventory date) and examine shipping records and determine that they were recorded in the proper period.
  - b. Select credit memos issued after year end and examine underlying documentation (for example, record of receipt of returned goods) to determine period to which credit memo is applicable and whether it was recorded in the proper period.
  - c. Inquire of the client if there are any unprocessed sales or customer credit memos. Inspect supporting documents to determine whether they should have been recorded prior to year end.

_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____



	<u>Done By</u>	<u>Date</u>	<u>W/P Ref.</u>
5. Ascertain that the following income accounts have been traced to the analysis working papers for examination of the related balance sheet accounts:			
a. Interest income (notes receivable, debt securities, capitalized leases, etc.)	_____	_____	_____
b. Dividend income and realized gain (marketable equity securities)	_____	_____	_____
c. Increase in investments accounted for on the equity method (investments)	_____	_____	_____
d. Gain on sale of property and equipment (property and equipment)	_____	_____	_____
6. Obtain (or prepare) an analysis of rent and royalty income and examine supporting agreements (should be related to examination of leases and other agreements).	_____	_____	_____

This audit program section has been completed in accordance with firm policy.

Date

\_\_\_\_\_  
Done by

\_\_\_\_\_  
Reviewed by

Done By	Date	W/P Ref.
------------	------	-------------

1. To determine that:

1. To determine that:
  - a. Reported expenses include costs which are properly allocable to the year (period) and are properly matched with revenues.
  - b. Recognition has been given to all costs and expenses (including losses) which should be recognized.
  - c. All tax temporary differences have been accounted for.
  - d. Extraordinary items have been properly classified and disclosed.
  - e. The income statement is prepared in conformity with generally accepted accounting principles consistently applied.
  - f. Costs and expenses are appropriately classified and described in the statement of income.

1. Obtain or prepare comparative analyses showing amounts for the current and preceding years or periods (and budgeted amounts) and the amounts of changes for the following (SAS No. 56 [AU section 329]):

Schedules showing the individual account balances which comprise each classification in the income statement (for example: comparative schedules of components of manufacturing costs plus opening inventory less closing inventory, selling expenses, general and administrative expenses, etc.).

- a. Consider whether the classification of expenses is in conformity with generally accepted accounting principles consistently applied.
- b. Obtain explanations for significant or unusual fluctuations in expense account balances from the preceding year (or period) and from budgeted amounts. (Consider results of work done on accrued expense balances for the current and preceding year.) (SAS No. 56 [AU section 329]).
- c. Obtain explanations for significant or unusual differences between the current year and preceding year relationships of statement classifications of expenses as percentages of revenue (SAS No. 56 [AU section 329]).
- d. Compare the inventory turnover and gross profit ratios for the current and preceding year (SAS No. 56 [AU section 329]).
2. Determines that the following expense accounts have been traced to the analysis working papers for examination of the related asset and liability balances:
  - a. Bad debt expense (allowance for doubtful accounts—trade receivables)
  - b. Insurance expense (prepaid insurance and accrued premiums for workmen's compensation)
  - c. Property taxes (prepaid and/or accrued property taxes)
  - d. Depreciation expense (property and equipment and accumulated depreciation)
  - e. Amortization costs (intangible assets)
  - f. Interest expense (notes payable, long-term debt, capitalized leases)
  - g. Provision for income taxes (liability for income taxes currently payable, deferred income taxes)
  - h. Realized losses on current investments (marketable equity securities)
  - i. Loss on sale or disposition of property and equipment (property and equipment)
3. Obtain or prepare analyses of the following accounts and examine supporting detail (on a completed or test basis as deemed appropriate):

	<u>Done By</u>	<u>Date</u>	<u>W/P Ref.</u>
a. Professional fees (lawyers' invoices should have been examined and noted during work on commitments and contingencies concerning pending litigation).	_____	_____	_____
b. Rent and royalty expense (should be related to examination of leases and other agreements—other lease obligations or license agreements may be disclosed).	_____	_____	_____
c. Officers' salaries and directors' fees (to determine that amounts agree with those authorized per the minutes of Board of Directors' meetings).	_____	_____	_____
d. Maintenance and repairs (if not already tested in connection with property and equipment; determine that expenses do not include amounts which should be capitalized).	_____	_____	_____
e. Travel and entertainment (review client's procedures for compliance with income tax requirements).	_____	_____	_____
f. Unusual classifications such as loss provisions for discontinued operations and plant closings.	_____	_____	_____
4. Consider obtaining or preparing analyses and examining supporting detail on a test basis for the following expenses:			
a. Research and development.	_____	_____	_____
b. Advertising.	_____	_____	_____
c. Contributions.	_____	_____	_____
5. Based on the assessment of control risk of assertions related to payroll, consider reconciling wages and salaries and payroll taxes to amounts reported per the payroll tax returns.			

This audit program section has been completed in accordance with firm policy.

Date

Done by

Reviewed by

Done By	Date	W/P Ref.
------------	------	-------------

## XVI. Litigation, Claims, and Assessments

### A. .430 Audit Objectives

1. Identify the existence of any contingencies arising from litigation, claims, and assessments; when the underlying cause occurred; the likelihood of an unfavorable outcome, and the amount or range of possible loss.
2. Determine that the financial statements include proper accruals and/or disclosure of the contingencies.

### B. .440 Substantive Test Procedures

1. Assemble findings concerning litigation, claims, and assessments from such other procedures as:
  - a. Reading minutes of meetings of stockholders, directors, and appropriate committees held during and subsequent to the period being audited.
  - b. Reading contracts, loan agreements, leases, and correspondence from taxing or other governmental agencies and similar documents.
  - c. Obtaining information concerning guarantees from bank confirmation forms.
  - d. Inspecting other documents for possible guarantees by the client.
2. Inquire of and discuss with management the policies and procedures adopted for identifying, evaluating, and accounting for litigation, claims, and assessments.
3. Obtain from management a description and evaluation of litigation, claims, and assessments that existed at the date of the balance sheet being reported on, and during the period from the balance sheet date to the date the information is furnished, including:
  - a. Identification of those matters referred to legal counsel.
  - b. Assurances from management, ordinarily in writing, that they have disclosed all such matters required to be disclosed by Statement of Financial Accounting Standards No. 5 [AC section C59].
4. Examine documents in the client's possession concerning litigation, claims, and assessments, including correspondence and invoices from lawyers.
5. Obtain assurance from management, ordinarily in writing, that they have disclosed all unasserted claims that the lawyer has advised them are probable of assertion and must be disclosed in accordance with Statement of Financial Accounting Standards No. 5 [AC section C59]. Also the auditor, with the client's permission, should inform the lawyer that the client has given the auditor this assurance. This client representation may be communicated by the client in the inquiry letter or by the auditor in a separate letter.
6. Request the client's management to send a letter of inquiry to those lawyers consulted by the client concerning litigation, claims, and assessments (see SAS No. 12 [AU section 337], for guidance).

This audit program section has been completed in accordance with firm policy.

Date

Done by

Reviewed by

	<u>Done By</u>	<u>Date</u>	<u>W/P Ref.</u>
<b>XVII. Subsequent Events</b>			
<b>A. .450 Audit Objectives</b>			
1. To identify any events or transactions occurring after the balance sheet date, but before issuance of the financial statements and auditor's report (subsequent events) which require adjustment or disclosure in the financial statements.	_____	_____	_____
2. To determine that the financial statements have been adjusted for changes in estimates resulting from evidence provided by subsequent events.	_____	_____	_____
3. To determine that the financial statements include adequate disclosure of evidence provided by subsequent events which should not result in adjustment of the financial statements but should be disclosed.	_____	_____	_____
<b>B. .460 Substantive Test Procedures</b>			
1. Read the latest available interim financial statements:			
a. Compare them with the financial statements being reported upon; and make any other comparisons considered appropriate in the circumstances.	_____	_____	_____
b. Inquire of officers and other executives having responsibility for financial and accounting matters as to whether the interim statements have been prepared on the same basis as that used for the statements under audit.	_____	_____	_____
2. Inquire of and discuss with officers and other executives having responsibility for financial and accounting matters as to:			
a. Whether any substantial contingent liabilities or commitments existed at the date of the balance sheet being reported on or at the date of inquiry.	_____	_____	_____
b. Whether there was any significant change in the capital stock, long-term debt, or working capital to the date of inquiry.	_____	_____	_____
c. Whether there were any significant changes in estimates with respect to amounts included or disclosed in the financial statements being reported on.	_____	_____	_____
d. Whether any unusual adjustments had been made during the period from the balance sheet date to the date of inquiry.	_____	_____	_____
3. Read the available minutes of meetings of stockholders, directors, and appropriate committees; as to meetings for which minutes are not available, inquire about matters dealt with at such meetings.	_____	_____	_____
4. Assemble pertinent findings resulting from response of client's legal counsel and other auditing procedures concerning litigation, claims, and assessments.	_____	_____	_____
5. Obtain a letter of representation, dated as of the date of the auditor's report, from appropriate officials, generally the chief executive officer and chief financial officer in accordance with SAS No. 19 (AU section 333).	_____	_____	_____
6. Make such additional inquiries or perform such procedures deemed necessary and appropriate to dispose of questions that arise in carrying out the foregoing procedures, inquiries, and discussions.	_____	_____	_____
This audit program section has been completed in accordance with firm policy.			
		Date	
Done by _____			
Reviewed by _____			

## AAM Section 6000

## WORKING PAPERS

Sample and blank working papers are presented for illustrative purposes only. They are intended as mere conveniences for users of this Manual who may want points of departure when designing their own formats to meet their individual needs. These illustrations are neither all-inclusive nor prescribed minimums. Auditors and accountants are to rely on professional standards and their individual professional judgment in determining the workpapers needed in the circumstances.

## TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
6100	Working Papers—General . . . . .	.01-.03
	General Discussion . . . . .	.02-.03
6200	Basic Elements of Format . . . . .	.01-.04
6300	Content of Working Papers . . . . .	.01-.06
	General Considerations . . . . .	.02
	Timesaving Considerations . . . . .	.03
	Symbols (Tick Marks) . . . . .	.04-.06
6400	Organization and Filing (Indexing) . . . . .	.01-.13
	Predetermined Indexing . . . . .	.02-.09
	Current and Permanent Files . . . . .	.10-.12
	Index Topics . . . . .	.13
6500	Sample Working Papers . . . . .	.010-.773
	General Comment . . . . .	.020-.030
	Assembly Sheet—Balance Sheet . . . . .	.040-.041
	Assembly Sheet—Results of Operations, Retained Earnings . . . . .	.050-.051
	Cash Flows Worksheet (Indirect Method) . . . . .	.060-.061
	Cash Flow Statement Worksheet . . . . .	.062-.063
	Gross Cash Flows from Operating Activities (Direct Method) . . . . .	.064-.065
	Adjusting Journal Entries . . . . .	.070
	Reclassification Entries . . . . .	.080
	Potential Adjustments . . . . .	.090-.091
	Potential Adjustments and Reclassifications . . . . .	.100-.101
	Working Trial Balance . . . . .	.110-.111
	Tax Return Worksheet—Reconciliation to Reported P & L . . . . .	.120-.121
	Confirmation Control Sheet . . . . .	.130
	Materials to Be Prepared by Client . . . . .	.140
	Lead Schedule (Sheet)—General Example . . . . .	.150-.151
	Cash—Lead Sheet . . . . .	.160-.161
	Petty Cash Count . . . . .	.170-.171
	Bank Reconciliation . . . . .	.180-.181
	Standard Bank Confirmation Inquiry . . . . .	.190
	Cash—Symbol Legend for Bank Reconciliations . . . . .	.200-.201
	Bank Transfer Schedule . . . . .	.210-.211
	Proof of Cash . . . . .	.220-.221
	Cash—Analytical Procedures . . . . .	.222-.223
	Marketable Equity Securities, Cost, Market & Gross Unrealized Gains (Losses) . . . . .	.230-.231

<i>Section</i>	<i>Paragraph</i>
<b>6500 Sample Working Papers—continued</b>	
Marketable Equity Securities—Analysis . . . . .	.240-.241
Marketable Equity Securities—Valuation Allowances . . . . .	.250-.251
Marketable Equity Securities—Analytical Procedures . . . . .	.252-.253
Notes Receivable . . . . .	.260-.261
Notes Receivable—Analytical Procedures . . . . .	.262-.263
Accounts Receivable—Lead Sheet . . . . .	.270-.271
Accounts Receivable—Confirmation Statistics . . . . .	.280-.281
Accounts Receivable—Reconciliation from Confirmation Date to Year End . . . . .	.290-.291
Accounts Receivable—Review of Post Balance Sheet Credit Memos . . . . .	.300-.301
Confirmation Control Sheet . . . . .	.310-.311
Accounts Receivable—Aging Analysis . . . . .	.320-.321
Accounts Receivable—Other . . . . .	.330-.331
Accounts Receivable—Analytical Procedures . . . . .	.332-.333
Allowance for Doubtful Accounts—Related Expense . . . . .	.340-.341
Allowance for Doubtful Accounts, Provisions, Write Offs and Recoveries . . . . .	.350-.351
Allowance for Doubtful Accounts—Analytical Procedures . . . . .	.352-.353
Inventories—Lead Sheet . . . . .	.360-.361
Inventory—Analysis from Physical to Year End . . . . .	.370-.371
Inventory—Test Counts . . . . .	.380-.381
Inventory Price Test—Raw Materials . . . . .	.390-.391
Inventory Price Tests of Work-in-Process and Finished Goods—General Note on Working Papers . . . . .	.400
Inventories—Analytical Procedures . . . . .	.401-.402
Prepaid Insurance and Related Expense . . . . .	.410-.411
Prepaid Insurance (Alternative Format) . . . . .	.420-.421
Property Taxes—Prepaid & Accrued . . . . .	.430-.431
Prepaid Expenses—Other . . . . .	.440-.441
Prepaid Expenses—Analytical Procedures . . . . .	.442-.443
Deposits & Miscellaneous Current Assets . . . . .	.450-.451
Property, Plant & Equipment, & Related Depreciation—Lead Analysis . . . . .	.460-.461
Property, Plant & Equipment—Additions . . . . .	.470-.471
Property, Plant & Equipment—Retirement & Dispositions . . . . .	.480-.481
Fixed Assets—Analytical Procedures . . . . .	.482-.483
Intangible Assets . . . . .	.490-.491
Intangible Assets—Analytical Procedures . . . . .	.492-.493
Accounts Payable—Lead Sheet . . . . .	.500-.501
Trade Accounts Payable—Schedule . . . . .	.510-.511
Unrecorded Liabilities Test . . . . .	.520-.521
Accounts Payable—Confirmation Differences . . . . .	.530-.531
Accounts Payable—Analytical Procedures . . . . .	.532-.533
Miscellaneous Current Liabilities . . . . .	.540-.541
Dividends Payable . . . . .	.550-.551
Liability for Payroll Taxes Withheld . . . . .	.560-.561
Accrued Payroll Taxes . . . . .	.570-.571
Accrued Payroll . . . . .	.580-.581
Accruals—Other . . . . .	.590-.591
Debt—Notes Payable & Related Interest . . . . .	.600-.601
Debt—Summary of Assets Pledged . . . . .	.610-.611
Notes Payable—Analytical Procedures . . . . .	.612-.613
Federal (State) Income Taxes—Accrued & Provided . . . . .	.620-.621
Provision for Federal (State) Income Taxes . . . . .	.630-.631
Deferred Income Taxes—Temporary Differences . . . . .	.640-.641

<i>Section</i>	<i>Paragraph</i>
6500	Sample Working Papers—continued
	Deferred Income Taxes—Temporary Differences When Net Operating Losses Exist . . . . .
	Contingent Liabilities and Commitments Other Than Leases . . . . .
	Capital Stock & Additional Paid-in Capital—Analysis . . . . .
	Capital Stock—Certificate Book Examination (Carryforward) . . . . .
	Retained Earnings—Analysis (Carryforward) . . . . .
	Revenue and Expense Working Papers—General Note . . . . .
	Legal Expense . . . . .
	Maintenance & Repairs Expense . . . . .
	Officers Salaries and Expense . . . . .
	Taxes, Licenses and Fees . . . . .
	Rents and Royalties . . . . .
	Interest Expense Recapitulation . . . . .
	Other Income . . . . .
	Other Expense . . . . .
	Expense Accounts—Analytical Procedures . . . . .

---

[The next page is 6101.]





# AAM Section 6100

## *Working Papers—General*

.01 Working papers serve both as tools to aid the auditor in performing his work, and as written evidence of the work done to support the auditor's report. SAS No. 41, *Working Papers* (AU section 339), provides authoritative guidance on the functions and nature, general content, and ownership and custody of working papers.

### **General Discussion**

.02 These sections present points of view on the organization and preparation of working papers and include selected illustrations of working papers, primarily analyses and schedules.

.03 Proper planning is important in the design of specific working papers if they are to serve the objective of aiding the auditor in the conduct of his work. For example, a well-planned working paper may be designed to provide information that will be needed later in the preparation of tax returns and other required reports, such as those to regulatory bodies, and may therefore eliminate the need for examining the same documents twice to obtain necessary information. The format and content of the working papers may vary with the individual preferences of auditors and firms. These preferences may be informal common practices or expressed as part of a firm's formal written policies and procedures. A firm should consider the nature of its practice and the services commonly provided to its clients, as well as professional standards in developing its procedures and policies on working papers. Those procedures and policies should permit the flexibility necessary to meet the needs of individual engagements.

---

[The next page is 6201.]



# AAM Section 6200

## *Basic Elements of Format*

.01 Working paper formats generally include at least the following for identification purposes:

- A title or heading comprised of (a) the name of the client, (b) a caption that briefly describes the paper's contents, (c) the nature of the engagement, and (d) the applicable period or closing date covered by the engagement.
- The initials or names of the auditors who performed and reviewed the work presented in the paper and the date the paper was completed.

.02 In instances when one working paper requires more than one page, some auditors present the heading on only the lead page, fasten or staple all the applicable pages together as a unit and number each page, for example, 1 of 5, 2 of 5, and so forth. Many auditors index each working paper in some organized pre-established manner. This provides for ease in cross-referencing to other relevant papers, for more organized indexing and filing, and for a form of control over the working papers. (See AAM section 6400.)

.03 Some auditors purchase standard analysis paper that includes preprinted blocks for the initials or signature of the preparer and reviewer, and the dates on which the paper was prepared and reviewed. Others design their own signature and reference blocks and have them imprinted on all of their analysis paper and lined pads. These signature blocks may include captions such as the following:

- prepared by client and tested by
- prepared by
- date prepared
- date tested
- reviewed by
- date reviewed
- source
- work paper reference
- footed by
- extensions checked by

.04 Some auditors prefer to identify client preparation of schedules and analysis by notations or codes, such as "PBC," for prepared by client, rather than use a detailed signature and reference block.

---

[The next page is 6301.]



# AAM Section 6300

## *Content of Working Papers*

.01 The content of working papers varies with the circumstances and needs of the auditors on individual engagements. Some firms, however, include various general and specific instructions on working paper content in their policies concerning working papers.

### **General Considerations**

.02 The following are some general considerations on working paper content that may be helpful.

- Working papers should be sufficiently intelligible, clear and neat so that another auditor who has had no previous association with the engagement can review the papers and determine the nature and extent of the work done and how the conclusions were reached that support the resulting auditor's report.
- The content of an individual working paper or group of related papers should include identification of the (1) source of the information presented (e. g., fixed assets ledger, cash disbursements journal), (2) the nature and extent of the work done and conclusions reached (by symbols and legend, narrative, or a combination of both), and (3) appropriate cross-references to other working papers.
- Before completion of the engagement, all questions or exceptions in the working papers should be resolved. If for some reason the auditor must leave the assignment without resolving all items, he should provide an open items listing on a separate temporary paper for the in-charge auditor's attention. An unresolved exception or incomplete explanation in the working papers may be construed by some as indication of an inadequate audit.
- Information and comments in the working papers generally represent statements of fact and professional conclusions. Accordingly, language should be clear and free from such vague judgmental adjectives as "good" or "bad." Conclusions should be supported by documented facts, especially if they concern the adequacy of the client's records.
- Working papers should be viewed as an integrated presentation of information. The auditor should cross-reference working papers to call attention to interaccount relationships and to reference a paper to other working papers summarizing or detailing related information.
- The preparer should view the working papers as if he were the in-charge auditor. All inferences and conclusions should be supported in the working papers and no misleading or irrelevant statements should be made.
- It is preferable to have negative figures in working papers indicated by parentheses instead of red figures to preserve their identity if the papers are photocopied or microfilmed.

### **Timesaving Considerations**

.03 There are a number of ways to save time and avoid unnecessary detail in working paper preparation. The following examples may be helpful.

- Whenever possible, have the client's employees prepare schedules and analyses. (This, of course, presupposes that the client has the necessary personnel to prepare the materials.)
- Use of a detailed audit program may eliminate the need for lengthy comments in the working papers on the scope of audit procedures. (However, some believe that such comments are still necessary when a detailed program is used; this is a matter of individual firm judgment.)

- Analyze asset (or liability) accounts and their related expense or income accounts on the same working paper. Examples include property, plant, and equipment, accumulated depreciation and related depreciation expense; notes receivable, accrued interest receivable and interest income; notes payable, accrued or prepaid interest, and interest expense; and accrued taxes and related provisions for tax expense.
- Avoid unnecessary computations. For example, if only the totals are meaningful and can be tested by a single independent computation, check the total and avoid unnecessary checking of details.
- Consider using carryforward analyses for accounts that tend to remain constant each year or vary only in accordance with a constant predetermined formula. Examples may include long-term assets and related depreciation or amortization such as plant, equipment, and intangibles, long-term debt with predetermined payment schedules, and capital stock.
- Consider using adding machine tapes instead of writing separate lists. Enter names or explanations on the tapes, when appropriate.
- Do not manually copy a document when photographic reproduction is feasible.
- If in doubt, use a larger sheet of paper—an unused portion is less of a problem than running out of space.
- Use symbols (tick marks) whenever possible, especially when the same symbol applies to several working papers.

## Symbols (Tick Marks)

**.04** When using symbols, it should be helpful to consider the following basic concepts:

- Symbols are merely a shorthand means of explaining a work step performed on a particular item of data. Symbols serve as means of conserving time and space and, if properly used, may ease review of the working papers.
- For a working paper to be clear to a reviewer or other reader, each symbol must be clearly explained. The explanation may be located on the same page as the items subjected to the work step, or on a separate legend that is clearly cross-referenced to and from the page that presents the applicable items.
- Symbols should be kept simple, distinctive and clear so they can be quickly written by the preparer and easily identified by a reviewer.

**.05** Applying these basic concepts is not that simple. Various auditors have conflicting notions about symbols. For example, on the matter of color, some believe all tick marks should be in color to make it easy to spot them in the working papers. Others believe it is a waste of time to keep “switching pencils” and observe that the color distinction is lost in photocopying. On another matter, some believe a set of standardized symbols can expedite preparation and review. Others believe that a set of standardized symbols is impractical because it lacks flexibility. Because it is generally agreed that symbols are an effective timesaver, it is desirable for firms to establish and communicate a policy on their use to maximize their potential effectiveness.

**.06** Commonly used symbols, as noted, should be simple and distinctive, not elaborate hieroglyphics. The most common are variations on a simple checkmark—for example, a checkmark with a slash, a checkmark with a circle at the end, a double checkmark, and any one of these within a circle. This abbreviated listing alone provides eight distinctive tick marks. Symbols may also include circled letters or numbers.

---

[The next page is 6401.]

# AAM Section 6400

## *Organization and Filing (Indexing)*

.01 Some auditors organize their working papers during the course of an engagement into general categories such as the following:

- Planning and administration.
- Internal control structure understanding and assessment of control risk.
- Substantive test working papers arranged in order of the balance sheet and income statement classifications.
- Trial balances, consolidating working papers, journal entries (adjustments, reclassifications, eliminations for consolidation), and potential entries.
- Draft reports, financial statements, and footnotes.
- Programs, checklists, and questionnaires (some keep these as separate units, others interfile them among working papers by statement classifications).
- General matters such as current minutes, contracts, and articles of incorporation that may apply to future engagements as well as current work.

Under this approach, actual indexing and filing would be deferred until the conclusion of the engagement.

### **Predetermined Indexing**

.02 Other practitioners and firms may use a predetermined indexing approach so that working papers can be indexed while the field work is still in progress. This offers the following advantages:

- Better control over working papers during the performance of field work.
- Constant arrangement of working papers in logical order to aid in review.
- Less time required in assembling and binding them into indexed files.
- Quicker access to specific working papers after they are filed.

.03 Predetermined indexing involves establishing a standard code for each section of the working papers, using letters and numbers, or numbers only. For example—

	Two Possible Alternatives	
Working trial balance—assets .....	B/S-A	T/B-1
Working trial balance—liabilities .....	B/S-L	T/B-2
Working trial balance—income & expense .....	P/L	T/B-3
Cash summary schedule .....	A	10
Receivables summary schedule .....	B	20
Inventory summary schedule .....	C	30

.04 Predetermined indexing requires recognition of the need for flexibility to meet unanticipated working paper needs or specialized industry requirements and it requires care to avoid undue complexity. Excessively complex references may obstruct rather than ease working paper preparation, cross-referencing and filing. Accordingly, it is helpful to develop an organizational plan adaptable to each section of the working papers. For example, some accountants classify working papers as lead schedules, primary detail, and secondary detail which might result in the following classification scheme for the above examples for cash:



	<u>Using Letters and Numbers</u>	<u>Using Only Numbers</u>
Lead schedule .....	(A)	(10)
Primary detail schedules .....	(A-1) (A-2) etc.	(10-1) (10-2) etc.
Secondary detail schedules .....	(A-1-1) (A-1-2) (A-1-3) (A-2-1) (A-2-2) (A-2-3)	(10-1-1) (10-1-2) (10-2-1) (10-2-2)

.05 Predetermined (standardized) indexing systems may be printed on separate pages for reference during the performance of field work and insertion in the front of working paper binders or files when the work is completed. Some firms have their uniform indexing systems printed directly on their file or binder covers.

.06 A well-organized indexing system need not be too complex. On a fairly small engagement, the indexing system may be a lead schedule divider tab between each major group of accounts with the name of the account on it (e.g., cash or accounts receivable) with the related workpapers filed behind the lead schedule without being individually indexed. At the completion of the engagement, the pages can be consecutively numbered within each account group (e.g., 1 of 10, 2 of 10, etc.), since there typically are not numerous or complex layers of supporting schedules, extensive cross-referencing can be avoided.

.07 On large engagements, particularly those with detailed charts of accounts, firms may consider it necessary to develop more complex indexing systems. In one such system, standard index number series are assigned as follows:

Current workpaper file .....	1000—7000
Permanent file .....	7100—9999

.08 In this system, each index number consists of four digits, with the addition decimals if necessary. Numbers ending with double zero are reserved for lead schedules whose total agrees with a line item on the working trial balance (index 1400). Single zeros are used for specific types of accounts (such as 2010, petty cash funds).

.09 Certain index numbers can be permanently assigned to each major financial statement classification. For instance, index 2000 may be assigned to cash. If various bank accounts exist, the cash schedules are assigned index numbers 2002, 2003, etc. Documentation such as supporting confirmations and lists of outstanding checks would be assigned index numbers commencing with 2001.1, 2001.2, etc. As for the permanent workpaper file, index 9300, for example, may be assigned to internal control structure. Accordingly, flowcharts and related questionnaires would be assigned index numbers in that series.

## Current and Permanent Files

.10 Working paper files are generally classified as current files and permanent (continuing) files. Current files contain information that is pertinent to a single engagement. Permanent files include information relevant to several recurring engagements. Some firms have their binder or file covers preprinted as current or permanent accompanied by pertinent portions of their uniform working paper indexes.

.11 A common challenge to many auditors is to keep the permanent file complete and current, and free from outdated or irrelevant materials that belong in an inactive file of superseded materials.

.12 Some auditors who have confronted one too many unwieldy permanent files believe all working papers should be classified as current with certain materials designated as matters of continuing interest to be carried forward each year until they become outdated. Under this approach, a firm may preprint its complete index on one type of file or binder cover and provide space to indicate whether specific contents are continuing or carry-forward in nature.

## Index Topics

.13 The following is a list of topics to consider in developing a standard index for working papers. This list is detailed, but is by no means all-inclusive. For example, specialized industries such as life insurance and banking need other specialized topics. Several of the topics may be eliminated, condensed or expanded, depending on the

auditor's needs and preferences. Topics that some auditors prefer to include in both the permanent and current files or only in the permanent files are followed by the letter (P).

Planning and administration

- . Time & budget data
- . General correspondence & memos
- . Planning memos—current
- . Planning notes & confirm copies for use in next engagement
- . Engagement letters
- . Schedules & analyses to be prepared by client
- . Minutes
- . Checklist of an administrative nature if required by firm policy

Audit or work program (Note 1)

Matters of continuing concern

- . Client's industry—background (P)
- . Description & brief history of client (P)
- . Data & ratio analysis of client's operations (P)
- . Client's facilities (P)
- . Articles of incorporation (P)
- . Bylaws (P)
- . Current contracts & agreements (P)
- . . Debt agreements (P)
- . . Leases (P)
- . . Labor contracts (P)
- . . Agreements with officers & key people (P)
- . . Pension plans (P)
- . . Profit-sharing plans (P)
- . . Stock warrants (P)
- . . Stock options (P)
- . . Other agreements (P)
- . Client's accounting policies & procedures (P)
- . Carryforward analyses (Note 2)

Internal control structure

- . Internal control structure questionnaire, narratives, flow charts, etc. (Note 3)

- . Initial assessment of control risk memos
- . Tests of controls

Reports, financial statements and footnotes, trial balances, and assembly sheets

- . Reports & financial statements (including letter, if any, on reportable conditions in internal control structure)
- . Consolidating working papers
- . Consolidation eliminating entries
- . Trial balance
- . Adjusting journal entries
- . Reclassification journal entries
- . Recap of possible adjusting entries
- . Assembly sheets supporting footnote disclosures (if the information is not included elsewhere in the working papers)
- . Disclosure checklists (if required by firm policy)
- . Supporting schedules (if required for reports to regulatory bodies or other reports)
- . Tax return information & work sheets (Note 4)

Assets

- . Cash
- . Marketable securities (and related income)
- . Notes receivable (and related interest)
- . Accounts receivable
- . . Summary and analyses
- . . Confirmation procedures (Notes 2 and 5)
- . Allowance for doubtful accounts & notes (Note 2)
- . Inventories
- . . Summary and analyses
- . . Price tests, cost & market
- . . Obsolescence review
- . . Observation, test counts & cutoff data
- . . LIFO determinations
- . Prepaid expenses
- . Other current assets
- . Investments

- . Property, plant & equipment, and accumulated depreciation, depletion & amortization (Note 2)
- . Intangible assets, deferred charges & amortization (Note 2)
- . Other assets
- . Intercompany accounts

**Liabilities**

- . Notes payable (and related interest)
- . Accounts payable
- . Accrued liabilities other than income taxes
- . Accrued income taxes (current & deferred), related provisions & credits (Note 2)
- . . Federal
- . . State & local
- . Other current liabilities
- . Long-term debt (including current maturities and capitalized leases) (Note 2)
- . Other long-term liabilities
- . Deferred income (Note 2)

**Commitments and contingencies**

- . Attorneys' letters
- . Abstracts of commitments & contingencies noted during review of minutes, contracts & agreements, confirmation responses, etc.
- . Subsequent events review
- . Management representation letter

**Equity (capital accounts) (Note 2)**

- . Capital stock
- . Additional paid-in capital
- . Treasury stock
- . Retained earnings
- . Partnership capital

**Revenue and expenses**

- . Operating revenues
- . Cost of sales
- . Selling, general & administrative
- . Other operating expenses
- . Other income

- . Other expense
  - . Extraordinary & unusual items
  - . Secondary schedules
  - . . Maintenance & repairs
  - . . Taxes other than income taxes
  - . . Rents
  - . . Royalties
  - . . Advertising costs
  - . . Legal fees
  - . . Interest expense recap
- 

## NOTES TO USER:

1. Alternate practices of filing audit programs include:
    - (a) Putting the program in a binder that is separate and distinct from the current and permanent files.
    - (b) Putting the signed off program in the current file.
    - (c) Keeping a master copy of the program in the permanent file with the signed off copies dispersed among the related working paper segments in the current file.
  2. Certain classifications may lend themselves to carry-forward working papers. Examples include allowances for doubtful accounts, brief summaries of confirmation response statistics, accumulated depreciation and amortization, deferred income taxes and open tax positions, long-term debt, and capital accounts.
  3. Internal control structure questionnaires may be filed as separate binders or as part of current or permanent files.
  4. Some firms and practitioners keep tax return preparation working papers in files that are completely separate from other types of engagement working papers.
  5. For situations involving voluminous confirmation responses or bulk inventory listings, the bulk materials may be filed in separate binders that are cross referenced to the pertinent working papers (for example: accounts receivable, accounts payable, and inventory).
- 

[The next page is 6501.]

# AAM Section 6500

## Sample Working Papers

.010 The samples of individual working paper formats included in this section are for illustrative purposes only. Blank working papers are provided as “tools” and in no way represent official positions or pronouncements of the AICPA. These working papers do not represent minimum requirements and do not purport to be all-inclusive. They should be used by or under the supervision of persons having adequate technical training and proficiency in the application of generally accepted accounting principles, generally accepted auditing standards, and Statements on Standards for Accounting and Review Services. Users of these working papers are urged to refer directly to applicable authoritative pronouncements when appropriate.

### General Comment

.020 These illustrations are included to help users of the manual save time by using them as points of departure in designing their own formats to meet their individual needs. For example, the analysis formats included among the samples tend to present a single step of activity between balances at the opening and closing dates of a fiscal year. If an auditor decides to do substantive testing prior to a fiscal year end, he may wish to use analysis formats that show activity between balances at the opening date of a fiscal year and a preliminary date during the year, and another step of activity from the preliminary date to the fiscal year end. Also the analysis formats in this section tend to present balance and activity captions as column headings with components shown on the line items as follows:

Description	Opening balance	Expense provision	Disburse- ments	Closing balance
	xxx	xxx	(xxx)	xxx
	xxx	xxx	(xxx)	xxx
	—	xxx	(xxx)	xxx
Totals .....	xxx	xxx	(xxx)	xxx

An alternate approach would be to present balance and activity captions as line items and use the column headings for components as shown in the following example:

	Totals	Components		
		...	...	...
Opening balance .....	xxx	xxx	xxx	—
Expense provision .....	xxx	xxx	xxx	xxx
Disbursements .....	(xxx)	(xxx)	(xxx)	(xxx)
Closing balance .....	xxx	xxx	xxx	xxx

.030 The decision as to appropriate format must be made by the individual auditor after considering all the circumstances of the engagement.

.040

ABC Co.  
 Assembly Sheet - Balance Sheet  
 12/31/X5

Initials	Date
Prepared By	
Approved By	

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Working paper ref.(B)	Classifications (A)(F)					Final balance(C) 12/31/X4	Per client(C) 12/31/X5
1		Current assets:					
2							
3	A	Cash					
4	B	Marketable securities					
5	C	Accounts receivable					
6	D	Less, allowance for doubtful accounts			( )	( )	
7		Net					
8	E	Inventories - raw materials					
9		- supplies					
10		- work-in-process					
11		- finished goods					
12		Total					
13	F	Prepaid expenses					
14	F	Other current assets					
15							
16		Total current assets					
17							
18	B	Other security investments					
19	B	Less, valuation allowance			( )	( )	
20							
21	J	Property plant & equipment, at cost					
22		Land					
23		Buildings					
24		Machinery & equipment					
25		Furniture & fixtures					
26		Leasehold improvements					
27							
28		Less, accumulated depreciation & amortization					
29		Buildings			( )	( )	
30		Machinery & equipment			( )	( )	
31		Furniture & fixtures			( )	( )	
32		Leasehold improvements			( )	( )	
33					( )	( )	
34		Net					
35	K	Other assets - Cash surrender value					
36		- Intangible assets					
37		- Other					
38							
39		TOTAL ASSETS					
40							

(9)		(10)	(11)	(12)		(13)	(14)	(15)	(16)
Adjusting Entries (D)		Balances as adj.		Reclassification Entries (E)		Final for report (F)		Remarks	
Dr.	Cr.	12/31/X5		Dr.	Cr.				
									1
									2
									3
									4
									5
									6
									7
									8
									9
									10
									11
									12
									13
									14
									15
									16
									17
									18
									19
									20
									21
									22
									23
									24
									25
									26
									27
									28
									29
									30
									31
									32
									33
									34
									35
									36
									37
									38
									39
									40

NOTES:

(A) Financial statement assembly sheets generally include the same captions (classifications) as the financial statements. For comparison purposes they also show the final amounts reported for the preceding year. For convenience, some auditors may include additional detail in support of the statement classifications on their assembly sheets.

The amounts for each caption would be supported by comparative lead sheets in each grouping of substantive test working papers. These lead sheets provide a trail to evidence of the work done and show comparatively how specific amounts in the client's accounts are grouped for classification in the financial statements for both the current year and as reported for the preceding year. (However, see the sample "Working Trial Balance" for an alternative approach)

(B) The column "work paper ref." in this illustration may include specific indexing codes used in a predetermined indexing approach.

(C) The final balances for the preceding year (12/31/X4 in this illustration) would be obtained from last year's audit report for the assembly sheets, and from last year's working papers for the supporting comparative lead sheets. The per client balances for the current engagement would be developed from the supporting comparative lead sheets which have been agreed to the client's general ledger.

(D) Adjusting entries would be posted to the comparative lead sheets and grouped. Then the grouped adjustments would be posted from the comparative lead sheets to these assembly sheets. The adjusted balances on the lead sheets as of 12/31/X5 would agree with the client's final account balances after posting of the adjusting entries.

(continued)



ABC Co.

Assembly Sheet - Balance Sheet (continued)  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Work paper ref. (B)	Classifications (A) (F)					Final balance (C) 12/31/X4	Per client (C) 12/31/X5
1		Liabilities					
2		Current Liabilities:					
3	N	Notes payable					
4	O	Accounts payable					
5	P	Accrued expenses					
6	Q	Income taxes					
7	Q	Deferred income taxes - current portion					
8	R	Other Current Liabilities					
9	S	Current Portion of Long-Term Debt					
10							
11		Total Current Liabilities					
12							
13	S	Long-Term Debt					
14							
15	Q	Deferred Income Taxes					
16							
17		Total Liabilities					
18							
19							
20		Stockholders' Equity:					
21	X	Common Stock					
22		Paid-in Capital					
23	y	Retained Earnings					
24		subtotal					
25	Z-1	Less, cost of common stock in treasury					
26							
27		Stockholders' equity					
28							
29		Total Liabilities and					
30		Stockholders' Equity					
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

(9)		(10)	(11)	(12)	(13)	(14)	(15)	(16)
Adjusting Entries (D)		Adjusted Balance	Reclassification Entries (E)		Final for report (F)	Remarks		
Dr.	Cr.	12/31/X5	Dr.	Cr.	12/31/X5			
								1
								2
								3
								4
								5
								6
								7
								8
								9
								10
								11
								12
								13
								14
								15
								16
								17
								18
								19
								20
								21
								22
								23
								24
								25
								26
								27
								28
								29
								30
								31
								32
								33
								34
								35
								36
								37
								38
								39
								40

NOTES: (continued)

(E) Columns are also provided for reclassification entries that may be needed for financial statement purposes but do not need to be posted to the client's accounts.

(F) The amounts presented in the assembly sheets and supporting comparative lead sheets should be consistent and clearly cross-referenced.

.041

## Assembly Sheet - Balance Sheet

Initials	Date
Prepared By	
Approved By	

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Working paper ref.	Classifications					Final balance	Per client
1	Current assets:						
2							
3	Cash						
4	Marketable securities						
5	Accounts receivable						
6	Less, allowance for doubtful accounts					( )	( )
7	Net						
8	Inventories - raw materials						
9	- supplies						
10	- work-in-process						
11	- finished goods						
12	Total						
13	Prepaid expenses						
14	Other current assets						
15							
16	Total current assets						
17							
18	Other security investments						
19	Less, valuation allowance					( )	( )
20							
21	Property plant & equipment, at cost						
22	Land						
23	Buildings						
24	Machinery & equipment						
25	Furniture & fixtures						
26	Leasehold improvements						
27							
28	Less, accumulated depreciation & amortization						
29	Buildings					( )	( )
30	Machinery & equipment					( )	( )
31	Furniture & fixtures					( )	( )
32	Leasehold improvements					( )	( )
33						( )	( )
34	Net						
35	Other assets - Cash surrender value						
36	- Intangible assets						
37	- Other						
38							
39	TOTAL ASSETS						
40							

**AAM § 6500.041**

## Assembly Sheet - Balance Sheet (continued)

Initials	Date
Prepared By	
Approved By	

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Work paper ref.	Classifications				Final balance	Per client	
1	Liabilities						
2	Current Liabilities:						
3	Notes payable						
4	Accounts payable						
5	Accrued expenses						
6	Income taxes						
7	Deferred income taxes - current portion						
8	Other Current Liabilities						
9	Current Portion of Long-Term Debt						
10							
11	Total Current Liabilities						
12							
13	Long-Term Debt						
14							
15	Deferred Income Taxes						
16							
17	Total Liabilities						
18							
19	Stockholders' Equity:						
20	{	Common Stock					
21		Paid-in Capital					
22		Retained Earnings					
23		subtotal					
24		Less, cost of common stock in treasury					
25							
26	Stockholders' equity						
27							
28	Total Liabilities and Stockholders' Equity						
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

**AAM § 6500.041**

.050

ABC Co.

Assembly Sheet - Results of Operations, Retained Earnings  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	W.P. ref.	Classifications (A)					Final Balances 12/31/X4	Per client 12/31/X5
1								
2	AA-1	Net sales						
3								
4	BB-1	Cost of sales*						
5								
6	BB-2	Research & development*						
7								
8	CC-1	Selling, general & administrative expenses*						
9								
10		Subtotal before other income & expense						
11								
12		Other income & expense						
13	B-2	Dividend income						
14	EE	Interest expense						
15	GG-1	Other expense						
16		Net						
17								
18		Total expenses before inc. taxes						
19		Income before income tax provisions						
20		Provision for income taxes						
21	Q	Current - federal						
22		- state						
23		subtotal						
24		Deferred - federal						
25		- state						
26		subtotal						
27								
28		NET INCOME						
29								
30	V	Retained earnings - beginning of year						
31								
32	V	Less = Dividends						
33								
34	V	Retained earnings, end of year						
35								
36		*Memo = Depreciation included above in						
37	BB-1	Cost of sales						
38	BB-2	R&D						
39	BB-3	SG&A						
40	J-1	Total						

(9)		(10)		(11)		(12)		(13)		(14)		(15)		(16)	
Adjusting		Balances		Reclassification		Final for									
Entries		as adj.		Entries		Report								Remarks	
Dr.	Cr.	12/31/X5		Dr.	Cr.										
															1
															2
															3
															4
															5
															6
															7
															8
															9
															10
															11
															12
															13
															14
															15
															16
															17
															18
															19
															20
															21
															22
															23
															24
															25
															26
															27
															28
															29
															30
															31
															32
															33
															34
															35
															36
															37
															38
															39
															40

NOTES:

(A) Each classification should be supported by a comparative lead sheet. This illustration includes the following assumptions.

- Research and development costs are of enough significance to require a separate caption.
- ABC Company is not required to report segment information or earnings per share.
- Depreciation expense is to be disclosed in the statement of changes in financial position; the auditor also noted depreciation expense on this working paper as a memo for his convenience.

(B) See SAS No. 56 for guidance on analytical procedures.



.051

## Assembly Sheet - Results of Operations, Retained Earnings

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	W.P. ref.	Classifications					Final Balances	Per client
1								
2		Net sales						
3								
4		Cost of sales*						
5								
6		Research & development*						
7								
8		Selling, general & administrative expenses*						
9								
10		Subtotal before other income & expense						
11								
12		Other income & expense						
13		Dividend income						
14		Interest expense						
15		Other expense						
16		Net						
17								
18		Total expenses before inc. taxes						
19		Income before income tax provisions						
20		Provision for income taxes						
21		Current - federal						
22		- state						
23		subtotal						
24		Deferred - federal						
25		- state						
26		subtotal						
27								
28		NET INCOME						
29								
30		Retained earnings - beginning of year						
31								
32		Less = Dividends						
33								
34		Retained earnings, end of year						
35								
36		*Memo = Depreciation included above in						
37		Cost of sales						
38		R&D						
39		SG&A						
40		Total						

**AAM § 6500.051**

## INDIRECT METHOD

.060 DEF Company

Date	Prepared By	Work Paper No.
	Reviewed By	

## Cash Flows Worksheet (A)

12/31/X5

		1		2		3		4	
From Assembly Sheets For Reported		Balance Sheet		and Other WPs					
Other WP				(B)		(B)		Net Change (C)	
REFS.				12/31/X4		12/31/X5		DR <CR>	
1	Cash			10000		5000		<5000>	(D)
2	Marketable Securities			50000		60000		10000	
3	Accounts Receivable, Net			400000		500000		100000	
4	Inventory			300000		350000		50000	
5	Prepaid Expenses & Other								
6	Current Assets			10000		15000		5000	
7									
8	(J-1) Property Plant and Equipment At Cost			500000		650000		150000	
9	Accumulated Depreciation			<100000>		<180000>		<30000>	
10									
11	Other Assets			50000		55000		5000	
12	Total Assets			1220000		1505000			
13									
14	Notes Payable			100000		130000		<30000>	
15	Accounts Payable			100000		110000		<10000>	
16	Accrued Expenses			20000		30000		<10000>	
17	Income Taxes			40000		50000		<10000>	
18	Deferred Income Taxes - Current								
19	Portion			20000		30000		<10000>	
20	Other Current Liabilities					5000		<5000>	
21	Current Portion - Long Term Debt			20000		30000		<10000>	
22									
23	(S-1) Long Term Debt			260000		300000		<40000>	
24	(Q-1) Deferred Income Taxes			60000		80000		<20000>	
25									
26	(X-1) Capital Stock			100000		120000		<20000>	
27	Additional Paid In Capital			100000		120000		<20000>	
28	Retained Earnings								
29	12/31/X4		400000	400000					
30	Net Income		200000					<200000>	
31	Dividends		<100000>					100000	
32	12/31/X5		500000			500000			
33	Total Liabilities & Equity			1220000		1505000			
34	Proof							-0-	
35									
36	Notes:								
37	(A) This working paper supports the Statement of Cash Flows (Indirect Method).								
38	Proponents of this schedule believe that taking shortcuts may often lead to								
39	excessive preparation time (not being able to reconcile because of omissions,								
40	etc.) and review time (unable to cross reference back to sources).								

5	6	7	8	9	10	
Net Income,						
Depreciation &						
Amortization						
						1
						2
						3
						4
						5
						6
						7
						8
<60000>	50000	Retirements				9
	(30000)	of PP & E				10
	20000					11
						12
						13
						14
						15
						16
						17
						18
						19
						20
						21
						22
						23
						24
						25
						26
						27
						28
						29
<200000>						30
						31
						32
						33
						34
						35
						36
(B) Use final amounts to be reported in Balance Sheet.						37
						38
(C) Before spreading changes for analysis purposes, the increases and						39
<decreases> column should be footed and balanced to zero.						40

### INDIRECT METHOD

Date	Prepared By	Work Paper No.
	Reviewed By	

Copyright © 1988, American Institute of Certified Public Accountants, Inc.

**AAM § 6500.061**

DEF Company

.062 Cash Flow Statement Worksheet

12/31/X5

Date	Prepared By	Work Paper No
	Reviewed By	

		1				2				3				4			
		Item								Operating Activities							
										Inflow				Outflow			
1		Net Income								200000							
2		Depreciation								60000							
3		Changes in Non Cash Current Accounts:															
4		Increase in Marketable Securities															
5		Increase in Accounts Receivable												100000			
6		Increase in Inventory												50000			
7		Increase in Prepaids and other Current Assets												5000			
8		Increase in Notes Payable															
9		Increase in Accounts Payable								10000							
10		Increase in Accrued Expenses								10000							
11		Increase in Income Taxes								10000							
12		Increase in Deferred Income Taxes								10000							
13		Increase in other Current Liabilities								5000							
14		Increase in Current Portion of Long Term Debt															
15		Changes in Non Current Assets:															
16		Purchase of Equipment															
17		Retirement of Equipment															
18		Increase in Other Assets												5000			
19		Changes in Non Current Liabilities and Equity															
20		Increase in Long Term debt															
21		Increase in Deferred Income Taxes								20000							
22		Proceeds from Sale of Stock															
23		Dividends Paid															
24										325000				160000			
25		Net Cash Flows								165000							
26																	
27		Net Increase <Decrease> in Cash (D)								<5000>							
28																	
29																	
30																	
31																	
32																	
33		Notes:															
34		(D) Net increase <decrease> in cash must prove to net increase															
35		<decrease> in reported balance sheet amounts of cash															
36																	
37																	
38																	
39																	
40																	

Investing Activities				Financing Activities							
Inflow		Outflow		Inflow		Outflow					
											1
											2
											3
		10000									4
											5
											6
				30000							7
											8
											9
											10
											11
											12
				10000							13
											14
											15
20000		200000									16
											17
											18
											19
				40000							20
											21
				40000							22
											23
						100000					24
20000		210000		120000		100000					25
		<190000>		20000							26
											27
											28
											29
											30
											31
											32
											33
											34
											35
											36
											37
											38
											39
											40



Date	Prepared By	Work Paper No
	Reviewed By	

Copyright © 1988, American Institute of Certified Public Accountants, Inc.

**AAM § 6500.063**

## DIRECT METHOD

DEF Company

.064 Gross Cash Flows from Operating Activities (A)

12/31/X5

Date	Prepared By	Work Paper No.
	Reviewed By	

1	2	3	4	5	6	7
From Assembly Sheets for Reported Balance Sheet and Cash Flows Worksheet						
WP						
Refs.						
1		Cash Received from Customers:				
2		Net Sales			1000	
3		<Increase> Decrease in Accounts Receivable			<100>	
4		Cash Received from Customers			900	
5						
6		Cash Paid to Suppliers and Employees:				
7		Cost of Sales			500	
8		Increase <Decrease> in Inventory			50	
9		<Increase> Decrease in Accounts Payable			<10>	
10		Cash Paid to Suppliers For Inventory			540	
11		Research and Development			20	
12		Selling, General and Administrative Expenses			80	
13		Other Expense			10	
14		Increase <Decrease> in Prepaid expenses and				
15	F	Other Current Assets *		(B)	5	
16		Increase <Decrease> in Other Assets			5	
17	P	<Increase> Decrease in accrued Expenses *		(C)	<10>	
18		<Increase> Decrease in Other Current Liabilities			5	
19					645	
20		Less: Non Cash Expenses - Depreciation			<60>	
21		Cash Paid to Suppliers and Employees			<585>	
22						
23		Dividends Received:				
24		Dividend Income			20	
25		<Increase> Decrease in Dividends Receivable		(B-1)		
26		Dividends Received			20	
27						
28		Interest Paid:				
29		Interest Expense			10	
30		<Increase> Decrease in Accrued Interest		(C-1)		
31		Interest Paid			10	
32						
33		Income Taxes Paid:				
34		Provision for Income Taxes			200	
35		<Increase> Decrease in Income Taxes Payable			<10>	
36		<Increase> Decrease in deferred Taxes - Current			<10>	
37		<Increase> Decrease in deferred Taxes - Non Current			<20>	
38		Income Taxes Paid			160	
39						
40						

DEF Company  
Gross Cash Flows Worksheet—Notes  
12/31/X5

Notes:

(A) This working paper is prepared in addition to the statement of cash flows worksheet when the direct method is used because SFAS No. 95 requires the presentation of a reconciliation of net income to net cash provided (used) by operating activities.

(B) This amount would normally include accrued dividends receivable. The amount of accrued dividends would be deducted and reflected at (B-1). For the purpose of simplicity, this illustration assumes that there are no beginning or ending balances in accrued dividends receivable.

(C) This amount would normally include accrued interest payable. The amount of accrued interest would be deducted and reflected at (C-1). For the purpose of simplicity, this illustration assumes that there are no beginning or ending balances in accrued interest receivable.

## DIRECT METHOD

.065 Gross Cash Flows from Operating Activities

Date	Prepared By	Work Paper No.
	Reviewed By	

From Assembly Sheets for Reported Balance Sheet and Cash Flows Worksheet											
WP											
Refs.											
1		Cash Received from Customers:									
2		Net Sales									
3		<Increase> Decrease in Accounts Receivable									
4		Cash Received from Customers									
5											
6		Cash Paid to Suppliers and Employees:									
7		Cost of Sales									
8		Increase <Decrease> in Inventory									
9		<Increase> Decrease in Accounts Payable									
10		Cash Paid to Suppliers For Inventory									
11		Research and Development									
12		Selling, General and Administrative Expenses									
13		Other Expense									
14		Increase <Decrease> in Prepaid expenses and									
15	F	Other Current Assets *									
16		Increase <Decrease> in Other Assets									
17	P	<Increase> Decrease in accrued Expenses *									
18		<Increase> Decrease in Other Current Liabilities									
19											
20		Less: Non Cash Expenses - Depreciation									
21		Cash Paid to Suppliers and Employees									
22											
23		Dividends Received:									
24		Dividend Income									
25		<Increase> Decrease in Dividends Receivable									
26		Dividends Received									
27											
28		Interest Paid:									
29		Interest Expense									
30		<Increase> Decrease in Accrued Interest									
31		Interest Paid									
32											
33		Income Taxes Paid:									
34		Provision for Income Taxes									
35		<Increase> Decrease in Income Taxes Payable									
36		<Increase> Decrease in deferred Taxes - Current									
37		<Increase> Decrease in deferred Taxes - Non Current									
38		Income Taxes Paid									
39											
40											

.070

ABC Co.  
Adjusting Journal Entries  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
W.P. Ref.				Client's acct. no.	Dr.	Cr.	
1							1
2							2
3	(D-1)		①	xxxx	xxxx (P)		3
4				xxxx		xxxx (P)	4
5							5
6							6
7							7
8							8
9							9
10			②				10
11							11
12				xxxx	xxxx (P)		12
13	(E-3)			xxxx		xxxx (P)	13
14							14
15							15
16							16
17							17
18							18
19							19
20							20
21							21
22							22
23							23
24							24
25							25
26							26
27							27
28							28
29							29
30							30
31							31
32							32
33							33
34							34
35							35
36							36
37							37
38							38
39							39
40							40

(P) = Traced to client's posting of general ledger.

NOTE:

Adjustments affect the client's accounts and are the client's entries. Their explanations should offer a reader enough information to know why the entry is needed. To merely say "adjust balance to actual" or "per working paper page xx" is not enough.



.080

ABC Company  
Reclassification Entries  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
					Workpaper Reference	Dr.	Cr.
1		Ⓐ					
2	Long-Term Debt				S	xxxxx	
3	Current Portion of Long-Term Debt				S		xxxxx
4	To reclassify the portion of long-term						
5	debt due within one year to current						
6	portion for statement purposes						
7							
8		Ⓑ					
9	Accounts Receivable				C	xxxx	
10	Accounts Payable				O		xxxx
11	To reclassify credit balances in accounts						
12	receivable to accounts payable for state-						
13	ment purposes						
14							
15	NOTE:						
16							
17							
18							
19							
20							
21							
22							
23							
24							
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

These entries are made for classification purposes within an individual financial statement and do not affect earnings. Normally, they do not affect the client's accounts and are made only for reporting purposes. However, their explanations should offer a reader enough information to understand why the entry is needed. For information purposes, it may be helpful to provide the client with a copy of the reclassification entries.



.090

ABC Co.  
Potential Adjustments  
12/31/X5

Initials	Date
Prepared By	
Approved By	

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
W.P. Refs.					Dr. (Cr.)	P&L Eff. increase (decrease)	Disposi- tion
1					(A)	(B)	AJE 1
2		Provision for doubtful accts.			10000	(10000)	(10000)
3		Allowance for doubtful accts.			(10000)		
4							
5	(C-5)	Re bal of xxx due from Zxywvts Ind.					
6	(D-1)	announced intent of bankruptcy					
7		12/27/X5.					
8							
9							AJE 2
10		Cost of sales			10000	(10000)	(10000)
11		Inventory - supplies			(10000)		
12							
13	(E-1) (E-D)	To adjust books to 12/31/X5 physical					
14		of supplies inventory at plant B.					
15							
16							
17	(O-4) (O-4)	SG&A			500	(500)	Waived as
18		Accts. payable			(500)		immaterial
19							
20		Unrecorded liabilities re:					
21		Phone 300					
22		Electric 200					
23							
24							
25							
26		Total P&L effect of potential adj.				(20500)	
27		Less, total effect of adjusting					
28		journal entries (AJEs)				(20000)	(20000)
29		P&L Effect of total items waived				(500)	
30							
31		Less - Estimated effect of income taxes on					
32		waived items and AJEs				200 (C)	8000 (C)
33		P&L effect net of income taxes				(300)	(12000)
34		Net income per financial statements-unadj.					72000
35		- final as adjusted					60000
36							
37		Waived items net of tax (300) as percent of final					
38		net income 00.5% (D)					
39							
40		Approved (signature of audit partner) Date (Completion					
		of field work)					

(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	
								1
								2
								3
								4
								5
								6
								7
								8
								9
								10
								11
								12
								13
								14
								15
								16
								17
								18
								19
								20
								21
								22
								23
								24
								25
								26
								27
								28
								29
								30
								31
								32
								33
								34
								35
								36
								37
								38
								39
								40

NOTES:

- (A) In this example, debits and credits are grouped in one column and should foot to zero. This was done merely to save space. An auditor may prefer to use separate columns for debits, credits and effect on income. There are many approaches for accumulating potential entries. For example, see the illustrative working paper for accumulating potential adjustments and reclassifications; it provides for accumulation of the effect of potential entries on the balance sheet as well as the income statement.
- (B) This column provides for identification of the cumulative effect (which may be material) of a series of relatively immaterial items which are biased in one direction.
- (C) For this illustration, the client's effective income tax rate is assumed to be 40%.
- (D) The resulting percent is arbitrarily selected solely for demonstrating arithmetic in this illustration.

.091

## Potential Adjustments

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	W.P. Refs.					Dr. (Cr.)	P&L Eff. increase (decrease)	Disposi- tion
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

Total P&L effect of potential adj.  
Less, total effect of adjusting  
journal entries (AJEs)  
P&L Effect of total items waived

Less = Estimated effect of income taxes on  
waived items and AJEs  
P&L effect net of income taxes  
Net income per financial statements-unadj.  
- final as adjusted

Waived items net of tax (300) as percent of final  
net income 00.5% (D)

Approved (signature of audit partner) Date (Completion  
of field work)

**AAM § 6500.091**

XYZ Corp.

.100

## Potential Adjustments and Reclassifications

3/31/X2

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	W.P. Ref.					Dr.	Cr.	Eff. on net inc. inc(dec)
1	B/S, P&L	Per financial statements-unadjusted						xxxxx
2		①						
3	J-8	Leased equipment, capitalized			xxxxx(a)			
4	J-8	Depreciation expense			xxxxx(b)			(xxxx)
5	T-2	Interest expense			xxxxx(c)			(xxxx)
6	T-1	Capitalized lease obligation					xxxxx	
7	J-8	Accumulated depreciation					xxxxx(b)	
8		Equipment rental expense					xxxxx(c)	xxxx
9		To capitalize loader under lease						
10		dated 10/15/X1 for period 1/1/X1-10/31/X6, recog-						
11		nize related depreciation and interest expense, and						
12		correct client's entry recording payments of xxxx						
13		as rental expense, memo info=						
14		Total rentals per lease	xxxxx	Orig prin	xxxxx(a)			
15		Fair val. of loader	xxxxx(a)	Pmts	xxx(c)			
16		Interest element	xxxxx	3/31/X2 bal	xxxxx			
17	T-1	②						
18		Capital lease obligation			xxxx			
19		Current portion-cap-lease oblig.					xxxx	
20		To segregate current portion						
21		of capitalized lease obligation-						
22		③						
23		Travel expense			xxx			(xxx)
24		Advance to employees					xxx	
25		Per results of confirmation						
26		of advances as of 3/31/X2. As of 3/31/X1, same						
27		sort of adjustment for \$yyy waived as immaterial						
28		Cumulative effect of potential entries						(xxxx)
29		Less, cumulative effect of items waived						xxx
30		Effect of AJEs & RJE's before inc. taxes						(xxxx)
31		Estimated income tax effect						xxxx
32		Net effect on financial statements						(xxxx)
33		Per financial statements, as adjusted						xxxxx
34								
35		Ø-Waived items net of inc. tax=X% of final net income						
36		(a)(b)(c)=Cross references only						
37	NOTE:							
38		This expanded working paper format allows for accumulating the						
39		effect of potential entries on working capital as well as P&L.						
40								

(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	
Assets		Balance sheet effect, increase (decrease)		Liabilities		Cap stock		Remarks & disposition
Current	Non cur.	Current	Non cur.	& pd. in	earnings			
xxxxxxx	xxxxxxx	xxxxxx	xxxxxxx	xxxxxxx	xxxxxxx			
	xxxxxx(a)							
					(xxxx)		AJE (1) see (a)	
					(xxxx)(c)		AJE (2) see (b)	
							AJE (3) see (c)	
	(xxxx)(b)		xxxxxx(c)					
					xxxx(c)		Split into 3 AJEs	
							(1) To capitalize lease	
							(2) To prov. depen	
							(3) To correct client's JE re rental exps.	
		xxxxx					} RJE (1)	
			(xxxx)					
(xxx)					(xxx)		Item waived as immaterial	
(xxx)	xxxxxx	xxxxx	xxxxxx		(xxxx)			
xxx					xxx			
-	xxxxxx	xxxxx	xxxxxx		(xxxx)			
		(xxxxx)			xxxxx			
-	xxxxxx	xxxxx	xxxxxx		(xxxx)			
xxxxxxx	xxxxxxx	xxxxxx	xxxxxxx	xxxxxxx	xxxxxxx			
Approved (signature of audit partner) Date (completion of field work)								

Approved (signature of audit partner) Date (completion of field work)

.101

## Potential Adjustments and Reclassifications

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
W.P. Ref.						Dr.	Cr.	Eff. on net inc. inc/dec
1	B/S. P&L	Per	financial statements-unadjusted					
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								
41								
42								
43								
44								
45								
46								
47								
48								
49								
50								
51								
52								
53								
54								
55								
56								
57								
58								
59								
60								
61								
62								
63								
64								
65								
66								
67								
68								
69								
70								
71								
72								
73								
74								
75								
76								
77								
78								
79								
80								
81								
82								
83								
84								
85								
86								
87								
88								
89								
90								
91								
92								
93								
94								
95								
96								
97								
98								
99								
100								

Cumulative effect of potential entries  
 Less, cumulative effect of items waived  
 Effect of AJEs & RJE's before inc. taxes  
 Estimated income tax effect  
 Net effect on financial statements  
 Per financial statements, as adjusted

**AAM § 6500.101**



.110

ABC Co.  
Working Trial Balance  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Account Number	Account	Title			Final 12/31/X4 Grouped for rep.	Account balances	Per books 12/31/X5
1							
2							
3							
4		ABC Co.					
5		Alternate Format-Working Trial Balance					
6		12/31/X5					
7							
8	Final 12/31/X4						
9	Grouped	Reclass & Final					
10	for	grouping account		Account title		Account	Per books
11	report	entries balances				number	12/31/X5
12							
13							
14		NOTES:					
15							
16		<p>This illustration is an alternative to the assembly sheets and lead sheets previously shown. It is a format that may be useful if the client's individual accounts are in a sequence that allows easy grouping into the statement classifications. The form should also offer enough space for symbols and notations of work done, cross references, and a clear identification of the statement groupings. If the client's trial balance is sequenced for easy grouping into statement classifications, pasting a copy of the trial balance onto formats similar to these illustrations may save preparation time.</p> <p>Proponents of this alternative format believe that preparation of lead sheets requires excessive time and duplicates information on the working trial balance. Proponents of the lead sheet approach argue that benefits such as the following more than justify the preparation time:</p> <ul style="list-style-type: none"> <li>• Lead sheets assemble working papers into groups that aid the review process and help staff see detail work in the context of the statements.</li> <li>• Comparative features of lead sheets aid the analytical review process.</li> <li>• Lead sheets offer a structure for delegating portions of the work to staff.</li> </ul>					
17							
18							
19							
20							
21							
22							
23							
24							
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

(9)		(10)	(11)	(12)	(13)	(14)	(15)	(16)	
Adjusting Journal Entries		Final	12/31/X5	Reclassifications	Final for	Working			
Dr.	Cr.	12/31/X5	for rep.	Dr.	Cr.	report	paper		
									1
									2
									3
									4
									5
									6
									7
									8
									9
Adjustments		Final	Grouping and	Reclassifications	Final for	Working			
Dr.	Cr.	12/31/X5	Dr.	Cr.	12/31/X5	report	paper		
									10
									11
									12
									13
									14
									15
									16
									17
									18
									19
									20
									21
									22
									23
									24
									25
									26
									27
									28
									29
									30
									31
									32
									33
									34
									35
									36
									37
									38
									39
									40

NOTES:

(continued)

- Lead sheets help avoid a cluttered "top summary" and thereby minimize the potential for clerical error.

The choice of format is the auditor's and should be based on his judgment about the most efficient way to structure the working papers for a particular engagement.

.111

## Working Trial Balance

Initials	Date
Prepared By	
Approved By	

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Account Number	Account	Title			Final Grouped for rep.	Account balances	Per books
1							
2							
3							
4							
5							
6							
7							
8							
9							
10							
11							
12							
13							
14							
15							
16							
17							
18							
19							
20							
21							
22							
23							
24							
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							
41							
42							
43							
44							
45							
46							
47							
48							
49							
50							
51							
52							
53							
54							
55							
56							
57							
58							
59							
60							
61							
62							
63							
64							
65							
66							
67							
68							
69							
70							
71							
72							
73							
74							
75							
76							
77							
78							
79							
80							
81							
82							
83							
84							
85							
86							
87							
88							
89							
90							
91							
92							
93							
94							
95							
96							
97							
98							
99							
100							

Alternate Format-Working Trial Balance

Final

Grouped  
for  
reportReclass. &  
grouping  
entriesFinal  
account  
balances

Account title

Account  
number

Per books

**AAM § 6500.111**

ABC Co.

## .120 Tax Return Worksheet - Reconciliation to Reported P&amp;L (B)

12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Line Ref.	Per Tax Return			Amount for rtn	Schedule M-1 Adjs		Reported NI in rtn format
	Classification				Increase	Decrease	
1	1	Gross sales					
2		Less, returns & allowances					
3		Net sales					
4	2	Cost of goods sold					
5	3	Gross profit					
6	4	Dividends					
7	5	Interest - obligations of U.S.					
8	6	Interest - other					
9	7	Gross rents					
10	8	Gross royalties					
11	9	(a) Capital gain					
12		(b) Net gain or loss Form 4797					
13	10	Other income					
14	11	TOTAL INCOME					
15							
16	12	Compensation of officers					
17	13	Salaries & wages					
18	14	Repairs					
19	15	Bad debts					
20	16	Rents					
21	17	Taxes					
22	18	Interest					
23	19	Contributions					
24	20	Amortization					
25	21	Depreciation					
26	22	Depletion					
27	23	Advertising					
28	24	Pension & profit sharing					
29	25	Employee benefit plans					
30	26	Other deductions					
31	27	TOTAL DEDUCTIONS					
32							
33	28	TAXABLE INCOME					
34							
35							
36							
37							
38							
39							
40							

(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
Classifications per reported income statement(A)							
Net sales	Cost of sales	R&D Exp.	SG&A Exp.	Interest Exp.	Other	Prov. for Inc. Tax	
							1
							2
							3
							4
							5
							6
							7
							8
							9
							10
							11
							12
							13
							14
							15
							16
							17
							18
							19
							20
							21
							22
							23
							24
							25
							26
							27
							28
							29
							30
							31
							32
							33
							34
							35
							36
							37
							38
							39
							40

NOTES:

- (A) This sample working paper reconciles the amounts per line items on the return with the reported income statement, and where necessary, directly to the source working papers. All schedule M-1 items should also be explained on this page or an attached set of supporting pages, and referenced to the supporting working papers. In some situations, it may be necessary to prepare this type of schedule in further detail than that of the reported statement of income (or loss).
- (B) Some auditors believe that this type of reconciliation should be prepared for all tax returns unless they are easily grouped from the trial balance or financial statements.

## .121 Tax Return Worksheet - Reconciliation to Reported P&amp;L

Initials	Date
Prepared By	
Approved By	

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Line Ref.	Per Tax Return			Amount for rtn	Schedule	M-1 Adjs	Reported NI in rtn format
	Classification				Increase	Decrease	
1	Gross sales						
2	Less, returns & allowances						
3	Net sales						
4	2 Cost of goods sold						
5	3 Gross profit						
6	4 Dividends						
7	5 Interest - obligations of U.S.						
8	6 Interest - other						
9	7 Gross rents						
10	8 Gross royalties						
11	9 (a) Capital gain						
12	(b) Net gain or loss Form 4797						
13	10 Other income						
14	11 TOTAL INCOME						
15							
16	12 Compensation of officers						
17	13 Salaries & wages						
18	14 Repairs						
19	15 Bad debts						
20	16 Rents						
21	17 Taxes						
22	18 Interest						
23	19 Contributions						
24	20 Amortization						
25	21 Depreciation						
26	22 Depletion						
27	23 Advertising						
28	24 Pension & profit sharing						
29	25 Employee benefit plans						
30	26 Other deductions						
31	27 TOTAL DEDUCTIONS						
32							
33	28 TAXABLE INCOME						
34							
35							
36							
37							
38							
39							
40							

**AAM § 6500.121**



ABC Company  
Confirmation Control Sheet  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

		(1)	(2)	(3)	(4)	(5)	
	Description Addressee	First request	Second request	Dates of Additional requests	Response received	W.P. Ref of response	
1	Client's rep  Attorneys letters John Doe, Esq. Brown & Jones						1
2							2
3							3
4							4
5							5
6	Bank confirmations See attached list						6
7							7
8							8
9							9
10							10
11	A/C Receivable See attached copies						11
12							12
13							13
14							14
15							15
16	Other descriptions and addresses such as custo- dians of market- able securities						16
17							17
18							18
19							19
20							20
21	and holders or trustees of long- term debt would be entered simi- lar to the above.						21
22							22
23							23
24							24
25							25
26	<u>NOTE:</u>  (A) Some auditors prepare this type of control sheet to include all confirmations and representations requested. Others prepare it for the client's representation and attorneys letters and use tissue copies as the control for other requests until routine prompt responses have cleared. Then the addressees who have not responded promptly would be entered on this control sheet for special attention.						26
27							27
28							28
29							29
30							30
31							31
32							32
33							33
34							34
35							35
36							36
37							37
38							38
39							39
40							40

.140

ABC Company

Materials to be Prepared by Client  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)
	Description		Date promised	Date received	Effect on time? (Yes/No)
1					1
2	Working trial balance				2
3					3
4	Bank reconciliations - 12/31 (copies)				4
5					5
6	Standard bank confirms				6
7					7
8	Accts. receivable - schedule				8
9	of balances written off				9
10					10
11	Accts. receivable - aged trial balance				11
12					12
13	Inventory - copy of physical, priced,				13
14	extended and summarized				14
15					15
16	Inventory - standard cost work-up				16
17					17
18	Prepaid insurance - analysis				18
19					19
20	Property taxes analysed				20
21					21
22	Property, plant & equipment				22
23	Additions schedule				23
24	Retirements schedule				24
25	Analysis of asset accounts				25
26	Analysis of accumulated				26
27	depreciation				27
28					28
29	Accounts payable listing				29
30					30
31	Maintenance and repair expense				31
32					32
33	<u>NOTE:</u>				33
34	(A) The above materials are illustrative only, and in no way				34
35	meant to be a comprehensive example of what materials may				35
36	be prepared by clients.				36
37					37
38					38
39					39
40					40

ABC Co.  
Lead Schedule (Sheet) - General Example  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Client's A/C Code	Account	Title	12/31/X4 Final Bal	← Bal per Client	12/31/X5 Adj. Dr. (Cr.)	→ Final Bal	W.P. Ref.
1							1
2							2
3							3
4							4
5							5
6							6
7							7
8							8
9	NOTES:						
10	(A) This type of schedule may be prepared for any caption in the						
11	financial statements to show a comparative grouping of individual						
12	accounts, aid in analytical review at a detailed level, and						
13	provide a trail between the financial statement classifications,						
14	the client's accounts, and the detailed papers concerning the						
15	work done.						
16	(B) Lead schedules may also include the preparer's conclusion on the						
17	results of the work done and notations on such matters as rela-						
18	tionship with other accounts, and proposed adjustments, reclass-						
19	ifications and disclosure requirements. Some firms require that						
20	the lead sheet include the auditor's individual conclusions on						
21	(C) This schedule can readily be modified to allow for two columns						
22	for adjustments, additional space for the account title, and						
23	additional columns for remarks.						
24							24
25							25
26							26
27							27
28							28
29							29
30							30
31							31
32							32
33							33
34							34
35							35
36							36
37							37
38							38
39							39
40							40

.151

## Lead Schedule (Sheet) - General Example

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Client's A/C Code	Account Title		Final Bal	← Bal per Client	Adj. Dr. (Cr.)	Final Bal →	W.P. Ref.
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

.160

ABC Company  
Cash - Lead Sheet  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Work paper Reference	Description					Account Number	Final Balance 12/31/X4
1							
2	(A-1)	Petty Cash (A)					
3							
4	(A-2)	Fifth National Bank (A)					
5							
6	(A-3)	Sixth National Bank (B)					
7							
8	(A-4)	Ninth State Bank - payroll A/C (B)					
9							
10	(A-5)	Uptown Bank & Trust Co. (B)					
11							
12	(A-6)	Downtown Bank & Trust Co. (B)					
13							
14							
15							
16	(A-7)	Standard bank confirms (A-7-1) (A) (B)					
17							
18	(A-8)	Symbol legend - bank reconciliations (A) (C)					
19							
20	(A-9)	Bank transfer schedule (A)					
21							
22							
23		NOTES:					
24		(A) Illustrative working papers are present for pages (A-1)					
25		(A-2) (A-7-1) (A-8) and (A-9) behind lead sheet.					
26		(B) Illustrations are not present for pages (A-3) (A-4) (A-5)					
27		(A-6) (A-7-2) (A-7-3) (A-7-4) and (A-7-5).					
28		(C) This symbol legend is located behind the reconciliation					
29		because the legend is on columns 9-16 of a 16-column					
30		spread sheet. This allows a reviewer to fold out the					
31		legend and see it as he looks at each reconciliation					
32		filed in front of it. If the papers are bound at the					
33		top of the page, and individual worksheets are spread to					
34		the right such as on 16-column paper, the legend may be					
35		set up so it folds out to the left. Then a reviewer can					
36		still see the legend as he looks at individual spread					
37		sheets.					
38							
39							
40							

(9)			(10)			(11)			(12)			(13)			(14)			(15)			(16)		
Per Books			Adjusting Entries			Journal			Adjusted Balance			Reclassification Entries			Final Balance								
12/31/X5			Dr.			Cr.			12/31/X5			Dr.			Cr.			12/31/X5					
																							1
																							2
																							3
																							4
																							5
																							6
																							7
																							8
																							9
																							10
																							11
																							12
																							13
																							14
																							15
																							16
																							17
																							18
																							19
																							20
																							21
																							22
																							23
																							24
																							25
																							26
																							27
																							28
																							29
																							30
																							31
																							32
																							33
																							34
																							35
																							36
																							37
																							38
																							39
																							40

.161

## Cash - Lead Sheet

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Work paper Reference	Description					Account Number	Final Balance
1							
2							
3							
4							
5							
6							
7							
8							
9							
10							
11							
12							
13							
14							
15							
16							
17							
18							
19							
20							
21							
22							
23							
24							
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

**AAM § 6500.161**



.170

ABC Company  
 Petty Cash Count  
 12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)
			Wrapped	Loose	Total
1	Currency:				
2	\$100.00				
3	50.00				
4	20.00				
5	10.00				
6	5.00				
7	1.00				
8	Coin:				
9	1.00				
10	.50				
11	.25				
12	.10				
13	.05				
14	.01				
15					
16	Vouchers, Undeposited Checks, etc.				
17	(describe):				
18					
19					
20					
21	Less-Receipts Subsequent to Cut-				
22	off (describe):				
23					
24					
25					
26	Amount of Fund-As Counted				
27	(Overage)-Shortage				
28					
29					
30					
31	Amount of Fund-Per Books				
32					
33	Receipt				
34					
35	The above detailed items were counted in my presence and				
36	returned to me intact by [insert individual's name],				
37	representative of [insert auditor's firm name].				
38					
39	Date and Time				
40	Cut-off Information: Last Recept. No.			Signature of Custodian	
				Last Check No.	

.171

## Petty Cash Count

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)
			Wrapped	Loose	Total
Currency:					
\$100.00					
50.00					
20.00					
10.00					
5.00					
1.00					
Coin:					
1.00					
.50					
.25					
.10					
.05					
.01					
Vouchers, Undeposited Checks, etc. (describe):					
Less-Receipts Subsequent to Cut-off (describe):					
Amount of Fund-As Counted (Overage)-Shortage					
Amount of Fund-Per Books					
<u>Receipt</u>					
The above detailed items were counted in my presence and returned to me intact by [insert individual's name], representative of [insert auditor's firm name].					
Date and Time					
Cut-off Information:					
Last Recept. No.					
Signature of Custodian					
Last Check No.					

ABC Company  
Bank Reconciliation - Fifth National Bank  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1							
2	Balance per Bank					xxxxx	C
3							
4	Add-Deposits in Transit						
5							
6							
7							
8							
9							
10							
11							
12	Less - Checks Outstanding						
13							
14							
15							
16							
17							
18							
19							
20							
21							
22	Other Reconciling Items						
23							
24	Balance per Books 12/31/X5						
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

.181

## Bank Reconciliation

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1								
2	Balance per Bank							
3								
4	Add Deposits in Transit							
5					<u>Date per</u>			
6					<u>Client Bank</u>			
7								
8								
9								
10								
11								
12	Less - Checks Outstanding							
13								
14					<u>Check #</u>	<u>Date</u>		
15								
16								
17								
18								
19								
20								
21								
22	Other Reconciling items							
23								
24	Balance per Books							
25								
26								
27								
28	See symbol legend pg							
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

[The next page is 6557.]



.190

STANDARD BANK CONFIRMATION INQUIRY  
Approved 1966 by  
AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS  
and  
BANK ADMINISTRATION INSTITUTE (FORMERLY NABAC)

ORIGINAL  
To be mailed to accountant

December 28, 19X5

Your completion of the following report will be sincerely appreciated. IF THE ANSWER TO ANY ITEM IS "NONE," PLEASE SO STATE. Kindly mail it in the enclosed stamped, addressed envelope *direct* to the accountant named below.

Report from

Yours truly,

ABC Company  
(ACCOUNT NAME PER BANK RECORDS)

(Bank) Fifth National Bank

By

Charles Delta  
Authorized Signature

P.O. Box 31428

Downtown, NJ xxxxx

Bank customer should check here if confirmation of bank balances only (Item 1) is desired.



NOTE—If the space provided is inadequate, please enter totals hereon and attach a statement giving full details as called for by the columnar headings below.

Accountant [Name of auditor]  
[Address of auditor]

1. At the close of business on December 31, 19X5 our records showed the following balance(s) to the credit of the above named customer. In the event that we could readily ascertain whether there were any balances to the credit of the customer not designated in this request, the appropriate information is given below.

AMOUNT	ACCOUNT NAME	ACCOUNT NUMBER	Subject to Withdrawal by Check?	Interest Bearing? Give Rate
\$ XXXX (A-2)	ABC Company	7806-8224	Yes	No

2. The customer was directly liable to us in respect of loans, acceptances, etc., at the close of business on that date in the total amount of \$ \_\_\_\_\_, as follows:

AMOUNT	DATE OF LOAN OR DISCOUNT	DUE DATE	INTEREST		DESCRIPTION OF LIABILITY, COLLATERAL SECURITY INTERESTS, LIENS, ENDORSERS, ETC.
			Rate	Paid to	
\$ XX,XXX	2/14/X4	2/14/X7	9%	12/31/X5	None (N-1)

3. The customer was contingently liable as endorser of notes discounted and/or as guarantor at the close of business on that date in the total amount of \$ None, as follows:

AMOUNT	NAME OF MAKER	DATE OF NOTE	DUE DATE	REMARKS
\$				

4. Other direct or contingent liabilities, open letters of credit, and relative collateral, were

(None)

5. Security agreements under the Uniform Commercial Code or any other agreements providing for restrictions, not noted above, were as follows (if officially recorded, indicate date and office in which filed):

(None)

Yours truly, (Bank) Fifth National Bank

Date January 5, 19X6

By

J. P. Valid

Asst. V.P.

Authorized Signature

Additional copies of this form are available from the American Institute of CPAs, 1211 Avenue of the Americas, New York, N. Y. 10036

Note: The confirmation response should be cross-referenced to all relevant working papers (in this example, to the bank reconciliation [page A-2] and notes payable [N-1]). The circled items should also be cross-referenced to indicate it was noted regarding working papers on commitments and contingencies. The bank should answer all questions. If some are not answered the bank should be called or written so the missing information can be obtained (in writing).

.200

ABC Company

Cash - Symbol Legend for Bank Reconciliations (See Notes)

12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

**NOTES:**

(A) This legend is placed behind the reconciliations because it is on the fold-out portion of a 16-column spread sheet. This approach allows the reviewer to unfold the legend and see the symbols as he reviews each reconciliation working paper.

If the papers are fastened at the top and the pages are double with spread sheets that unfold to the right, the legend can be set up so that it unfolds to the left side or bottom of the page. Then a reviewer may still see the legend as he looks at individual spread sheets.

(B) In this example, no exceptions were noted. However, if any were present, a separate symbol and explanation cross-referencing to an exception listing would also be included in this legend.

(C) In this example, it is assumed that based on the auditor's assessment of control risk for relevant assertions, the following steps were performed at a preliminary date and recorded elsewhere in the working papers:

(i) Preparation of proofs of cash to test total activity per the cash receipts and cash disbursements journal.

(ii) Comparison of entries per the cash disbursements journal to paid checks for date, number, payee, amount, and examination of check for proper signature and comparison of endorsement with identification of payee.

(iii) Accounting for all checks issued during a test month as paid, outstanding or void.

A-8

(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
							1
							2
							3
							4
							5
							6
							7
							8
							9
							10
							11
							12
							13
							14
							15
							16
							17
							18
							19
							20
							21
							22
							23
							24
							25
							26
							27
							28
							29
							30
							31
							32
							33
							34
							35
							36
							37
							38
							39
							40

(A) = To cash lead sheet

W = Footed, cross-footed

C = Confirmed by bank

T/B = Agreed to working trial balance

G/L = Agreed to general ledgers

T = Deposit in transit traced to Jan. XX, 19X6 cutoff bank statement and cash receipts book for amount and dates indicated, in-transit period appears reasonable.

W = Examined paid check returned with January XX, 19X6 cutoff bank statement; date check number and amount agrees with outstanding check list. Compared date, number, payee and amount per check to cash disbursements journal, found they agreed without exception (B)

W = Outstanding check not returned with bank cutoff statement. Compared date, check number and amount to cash disbursements journal and supporting voucher; compared payee and account distribution per cash disbursements journal to supporting voucher; found voucher properly approved and found items compared in agreement without exception. (B)

[The next page is 6561.]





## .201 Cash - Symbol Legend for Bank Reconciliations

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

(A) = To cash lead sheet

W = Footed, cross-footed

C = Confirmed by bank

T/B = Agreed to working trial balance

G/L = Agreed to general ledgers

T = Deposit in transit traced to Jan. XX, 19X6 cutoff bank statement and cash receipts book for amount and dates indicated, in-transit period appears reasonable.

W = Examined paid check returned with January XX, 19X6 cutoff bank statement; date check number and amount agrees with outstanding check list. Compared date, number, payee and amount per check to cash disbursements journal, found they agreed without exception.

✓ = Outstanding check not returned with bank cutoff statement. Compared date, check number and amount to cash disbursements journal and supporting voucher; compared payee and account distribution per cash disbursements journal to supporting voucher; found voucher properly approved and found items compared in agreement without exception.

ABC Company  
Bank Transfer Schedule  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Reviewed bank statements and cash receipts & disbursement journals from 12/XX/X5 to 1/YY/X6 for bank transfers of \$XXX or larger. (A)							
Check No.	Bank Accounts From	To	Amount	Date disbursed per Books (B)	Date deposited per Bank (C)	Book (B)	Bank (C)
1010	5th Natl.	Downtown	xxxxx	12/31	1/05	(A-2)	12/31 1/02 (T)
1009	5th Natl.	9th State	xxxxx	12/31	1/04	(A-2)	12/31 1/02 (T)
5440	6th Natl.	Downtown	xxxx	1/03	1/04	1/03	1/06
1040	Uptown	Downtown	xxxx	12/30	1/05	Ø	12/30 1/03 (T)
Ø - Should be cross-referenced to outstanding checklist of applicable bank reconciliations							
(T) - Should be cross-referenced to deposit in transit per applicable bank reconciliation							
NOTES:							
(A) The number of days before and after the balance sheet date selected for testing will depend on the auditor's study and evaluation of internal accounting control; the use of a minimum dollar amount in selecting transfers also depends on the auditor's judgment concerning materiality.							
(B) Receipts and disbursements per books should be recorded in the same month.							
(C) Any disbursements with bank statement dates that precede the dates per books should be investigated.							
(A-9)							

.211

## Bank Transfer Schedule

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Reviewed bank statements and cash receipts & disbursement journals from to for bank transfers of \$ or larger.							
1	Check	Bank Accounts			Date disbursed per		Date deposited per	
2	No.	From	To	Amount	Books (B)	Bank (C)	Book (B)	Bank (C)
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

.220

ABC Company

Proof of Cash 9/30 - 12/31/X5

12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
(Name of Bank)	(Bank A/C Number)	Recon. of balance 9/30/X5	Activity 10/1-12/31		Recon. of balance 12/31/X5			
			Receipts	Disb.				
1							1	
2	Balances and activity per						2	
3	bank statements	xxxxxx	xxxxxx	(xxxxxx)	xxxxxx		3	
4							4	
5	Deposits in transit						5	
6	9/30/X5	xxxx	(xxxx)				6	
7	12/31/X5		xxxxxx		xxxxxx		7	
8							8	
9	Outstanding checks						9	
10	9/30/X5	(xxxx)		xxxx			10	
11	12/31/X5			(xxxxxx)	(xxxxxx)		11	
12							12	
13	Other reconciling items						13	
14							14	
15	(Describe)	xxx		(xxx)			15	
16			xxx		xxx		16	
17							17	
18							18	
19	Per books	xxxxxx	xxxxxx	xxxxxx	xxxxxx		19	
20							20	
21							21	
22							22	
23	NOTES:						23	
24	(A)	All columns and lines should foot and cross-foot; and there should be clear indications of the work done.						24
25								25
26	(B)	Some find it helpful to prepare this analysis by (1) first entering the bank reconciliations of the opening and closing balances, (2) then identifying the deposits and disbursements per the bank statements and the client's cash receipts journal and cash disbursements journals, and (3) analyse and complete reconciliation of deposits and disbursements.						26
27								27
28								28
29								29
30								30
31	(C)	See sections 5400.080 and 5400.100--110, Illustrative Audit Objectives and Audit Procedures.						31
32								32
33								33
34								34
35								35
36								36
37								37
38								38
39								39
40								40

.221

## Proof of Cash

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
(Name of Bank)	(Bank A/C Number)		Recon. of balance 9/30/X5	Activity 10/1-12/31 Receipts Disb.		Recon. of balance 12/31/X5	
1							
2	Balances and activity per						
3	bank statements		xxxxx	xxxxx	(xxxxx)	xxxxxx	
4							
5	Deposits in transit						
6	9/30/X5		xxxx	(xxxx)			
7	12/31/X5			xxxxx		xxxxxx	
8							
9	Outstanding checks						
10	9/30/X5		(xxxx)		xxxx		
11	12/31/X5				(xxxxx)	(xxxxxx)	
12							
13	Other reconciling items						
14							
15	(Describe)		xxx		(xxx)		
16				xxx		xxx	
17							
18							
19	Per books		xxxxx	xxxxx	xxxxxx	xxxxxx	
20							
21							
22							
23							
24							
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

.222

ABC Co.

Cash - Analytical Procedures

12/31/X5

Date	Prepared By	Work Paper No.
	Reviewed By	

	1				2				3				4				5				6				7			
	Bank A/C				G/L A/C				Balance				Balance				Change				W/P References -				Investigation of			
	No.				No.				12/31/X4				12/31/X5								Material Changes							
1																												
2																												
3																												
4																												
5																												
6																												
7																												
8																												
9																												
10																												
11																												
12																												
13																												
14																												
15																												
16																												
17																												
18																												
19																												
20																												
21																												
22																												
23																												
24																												
25																												
26																												
27																												
28																												
29																												
30																												
31																												
32																												
33																												
34																												
35																												
36																												
37																												
38																												
39																												
40																												

,223

## Cash - Analytical Procedures

Date	Prepared By	Work Paper No.
	Reviewed By	

1		2		3		4		5		6		7	
Bank A/C		G/L A/C		Balance		Balance		Change		W/P References - Investigation of Material Changes			
No.		No.											
1													
2													
3													
4													
5													
6													
7													
8													
9													
10													
11													
12													
13													
14													
15													
16													
17													
18													
19													
20													
21													
22													
23													
24													
25													
26													
27													
28													
29													
30													
31													
32													
33													
34													
35													
36													
37													
38													
39													
40													



Marketable Equity Securities, Cost, Market &  
Gross Unrealized Gains (Losses)

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Description	No. of shares	12/31/X5 Cost	Market value (A) per share	amt	Gross unrealized (A) Gain	(Loss)	
1							1
2 <u>Current</u>							2
3 XYZ Corp 5% cum pfd	xxx	xxxxx	xx	xxxxx	xxxx		3
4 UVW Co. 6% pfd	xxx	xxxx	xx	xxxx		(xxx)	4
5 Manx Corp com	xxx	xxxx	xx	xxxx	xxx		5
6		xxxxx		xxxxx	xxxx		6
7					(xxx)	(xxx)	7
8 Net unrealized gain					xxxx		8
9 Carrying amount 12/31/X5		xxxxx					9
10							10
11 <u>Non Current</u>							11
12 Amalgamated Co com	xxxx	xxxxx	xx	xxxxx		(xxxx)	12
13 WXY Co. 8% cv pfd	xxxx	xxxxx	xx	xxxxx	xxx		13
14		xxxxx		xxxxx	xxx	(xxxx)	14
15							15
16 Net unrealized loss		(xxx)				xxx	16
17 Carrying amount 12/31/X5		xxxxx		xxxxx		(xxxx)	17
18							18
19							19
20							20
21							21
22							22
23							23
24 <del>Ø</del> Valuation allowance required							24
25							25
26							26
27 <u>NOTE:</u>							27
28							28
29 (A) The above columns for market value, gross unrealized gains and							29
30 gross unrealized losses may also be worked into the marketable							30
31 securities analysis (section 500.240) if wider analysis paper							31
32 is available. This would avoid the need to recopy or photocopy							32
33 the descriptions, numbers of shares and costs for the above.							33
34							34
35							35
36							36
37							37
38							38
39							39
40							40

.231

**Marketable Equity Securities, Cost, Market &  
Gross Unrealized Gains (Losses)**

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Description	No. of shares	Cost	Market value per share	amt	Gross unrealized Gain	(Loss)	
1								
2	<u>Current</u>							
3								
4								
5								
6								
7								
8	Net unrealized							
9	Carrying amount							
10								
11								
12	<u>Non Current</u>							
13								
14								
15								
16								
17	Net unrealized							
18	Carrying amount							
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

ABC Company

.240

Marketable Equity Securities - Analysis

12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Description	12/31/X4 Number of Shares	Balance Cost	Additions		Sales and	
				Date	No. of Shares	Cost	Date   Shares   Cost
1	Current						
2	XYZ Corp. 5% Cum Pfd	xxx	xxxxx				
3	UVW Co. 6% Pfd	xxx	xxxxx				11/30 xxx xxxx
4	Boxer Ind com	xxx	xxxxx				9/15 xxx xxxx
5	Manx Corp com			3/15	xxx	xxxxx	
6							
7			xxxxx			xxxxx	xxxxx
8							
9							
10							
11							
12							
13							
14							
15							
16	Non Current						
17	Amalgamated Co com	xxx	xxxxx		xxx	xxxxx	
18	WXY Co. 8% Cv Pfd	xxx	xxxxx				
19			xxxxx			xxxxx	
20							
21	Dividend income - accrued rec - per client						
22	Adjustment - accrued div re WXY Co. 8% Cv Pfd						
23	Final 12/31/X5						
24							
25							
26	NOTES:						
27							
28	(A)	The auditor may wish to use wider paper and insert the following					
29		additional columns between "12/31/X5 balance at cost" and the					
30		columns on dividend income:					
31	•	Market value per share					
32	•	Market value amount					
33	•	Gross unrealized gains					
34	•	Gross unrealized losses					
35							
36	(B)	The dividend income analysis was included above so the auditor					
37		could refer to the timing of additions, sales and dispositions					
38		on the same page when checking dividends earned.					
39							
40							

(9)			(10)	(11)	(12)	(13)	(14)	(15)	(16)	
Dispositions			12/31/X5	Bal (A)	Dividend Income (B)					
Proceeds			Realized Gain (Loss)	No. of Shares		Accrued 12/31/X4	Earned 19X5	Collected 19X5	Accrued 12/31/X5	
				xxx	xxxxx	xxx	xxxxx	xxxxx	xxx	1
				xxx	xxxxx	xxx	xxxxx	xxxxx	xxx	2
xxxxx			xxx							3
xxxxx			(xxx)			xxx	xxx	xxx		4
				xxx	xxxxx		xxx	xxx	xxx	5
										6
xxxxx			xxx		xxxxx	xxx	xxxxx	xxxxx	xxx	7
										8
										9
										10
										11
										12
										13
										14
										15
				xxx	xxxxx	xxx	xxxxx	xxxxx	xxx	16
				xxx	xxxxx	xxx	xxxxx	xxxxx		17
					xxxxx	xxx	xxxxx	xxxxx	xxx	18
					xxxxx	xxx	xxxxx	xxxxx	xxx	19
										20
						xxx	xxxxx		xxx	21
							xxx		xxx	22
							xxxxx		xxxxx	23
										24
										25
										26
										27
										28
										29
										30
										31
										32
										33
										34
										35
										36
										37
										38
										39
										40

.241

## Marketable Equity Securities - Analysis

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Description		Number of Shares	Balance Cost	Additions No. of Date/Shares Cost		Sales and Date/Shares Cost	
1	<u>Current</u>							
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16	<u>Non-Current</u>							
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

**AAM § 6500.241**

ABC Company

.250

Marketable Equity Securities - Valuation Allowances  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
				Val allow 12/31/X4	Dr or (Cr) to Net income(A)	(Cr) to Stkhldrs equity(A)	Val allow 12/31/X5
1							
2	Current portfolio						
3							
4	Market valuation			70000 Ø			75000 (B)
5	Cost			75000 Ø			72000 (B)
6	Net unrealized gain (loss)			( 5000 ) Ø			3000 (B)
7							
8	Val. allowance required			5000 Ø	( 5000 )		0
9							
10							
11	Non-current portfolio						
12							
13	Market valuation			82000 Ø			81000 (B)
14	Cost			80000 Ø			82000 (B)
15	Net unrealized gain (loss)			2000 Ø			( 1000 ) (B)
16							
17	Val allowance required			-0- Ø		1000	1000
18							
19	Ø - Per 12/31/X4 working papers						
20							
21							
22	NOTES:						
23							
24	(A) See Statement of Financial Accounting Standards No. 12,						
25	paragraph 11.						
26							
27	(B) This illustration uses summary captions rather than a listing						
28	of the individual securities in each portfolio on the assump-						
29	tion that amounts are cross-referenced to the related illus-						
30	trative working papers on cost, market, & gross unrealized						
31	gains (losses); and analysis of balances and activity.						
32							
33							
34							
35							
36							
37							
38							
39							
40							

## .251 Marketable Equity Securities - Valuation Allowances

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
					Val allow	Dr or (Cr) to Net income	Stkhldrs equity	Val allow
1								
2	Current portfolio							
3								
4	Market valuation							
5	Cost							
6	Net unrealized gain (loss)							
7								
8	Val. allowance required							
9								
10								
11	Non-current portfolio							
12								
13	Market valuation							
14	Cost							
15	Net unrealized gain (loss)							
16								
17	Val allowance required							
18								
19	Per working papers							
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								



ABC Co.

## Marketable Securities - Analytical Procedures

Date	Prepared By	Work Paper No.
	Reviewed By	

Copyright © 1988, American Institute of Certified Public Accountants, Inc.

.253

## Marketable Securities - Analytical Procedures

Date	Prepared By	Work Paper No.
	Reviewed By	

G/L A/C				Balance				Balance				Differences				W/P Ref Follow Up of Material Differences			
No.																			
1				Marketable Securities															
2				Allowance - Unrealized Losses															
3				Realized Gains															
4				Realized Losses															
5				Unrealized Losses															
6				Dividend Income															
7																			
8																			
9																			
10																			
11																			
12																			
13																			
14																			
15																			
16																			
17																			
18																			
19																			
20																			
21																			
22																			
23																			
24																			
25																			
26																			
27																			
28																			
29																			
30																			
31																			
32																			
33																			
34																			
35																			
36																			
37																			
38																			
39																			
40																			

ABC Company  
Notes Receivable  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
	Maker (Endorser)			Date Made Due		Original Terms of amount repayment		Collateral	Interest rate
1									
2									
3									
4									
5									
6									
7									
8									
9									
10									
11									
12									
13									
14									
15									
16									
17									
18									
19									
20									
21									
22									
23									
24									
25									
26									
27									
28									
29	<u>NOTE:</u>								
30	(A) This analysis, with some minor modification (provision for market								
31	valuations, and analysis of premium or discount) may also be used								
32	for investments in marketable debt securities.								
33									
34									
35									
36									
37									
38									
39									
40									

**AAM § 6500.260**

.261

## Notes Receivable

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Maker (Endorser)		Date Made Due		Original Terms of amount repayment	Collateral		Interest rate
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

**AAM § 6500.261**

.262

ABC Co.

## Notes Receivable - Analytical Procedures

Date	Prepared By	Work Paper No.
	Reviewed By	

	12/31/X5	2	3	4	5	6	7
	G/L A/C No.			Balance 12/31/X4	Balance 12/31/X5	Difference	W/P Ref Follow Up Of Material Differences
1		Notes Receivable					
2		Interest Income					
3							
4							
5							
6							
7							
8		Ratio Analysis:		19X4	19X5		
9							
10		Interest Earned					
11		Average Notes Outstanding					
12							
13							
14							
15							
16							
17							
18							
19							
20							
21							
22							
23							
24							
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

Date	Prepared By	Work Paper No
	Reviewed By	

## 263 Notes Receivable - Analytical Procedures

No.	G/L A/C	Balance				Balance				Difference				W/P Ref Follow Up Of Material Differences			
		12/31/X4				12/31/X5											
1																	
2																	
3																	
4																	
5																	
6																	
7																	
8																	
9																	
10																	
11																	
12																	
13																	
14																	
15																	
16																	
17																	
18																	
19																	
20																	
21																	
22																	
23																	
24																	
25																	
26																	
27																	
28																	
29																	
30																	
31																	
32																	
33																	
34																	
35																	
36																	
37																	
38																	
39																	
40																	



## Working Papers

ABC Company

.270

Accounts Receivable - Lead Sheet  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Work paper ref	Account titles					Client's acct. no.	Final Bal. 12/31/X4
1							
2							
3							
4							
5							
6							
7							
8							
9							
10							
11							
12							
13							
14							
15							
16							
17							
18							
19							
20							
21							
22							
23							
24							
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	
Per client	A.J.E.s		Balance as adjusted	Remarks				
12/31/X5	Dr.	Cr.	12/31/X5					
				<b>NOTES:</b>  (A) This format may be expanded to show columns for reclassification entries.  (B) The account titles and other captions on this work sheet are also merely illustrative. Actual titles will depend on the circumstances of the engagement and the needs and preferences of the auditor.				1
								2
								3
								4
								5
								6
								7
								8
								9
								10
								11
								12
								13
								14
								15
								16
								17
								18
								19
								20
								21
								22
								23
								24
								25
								26
								27
								28
								29
								30
								31
								32
								33
								34
								35
								36
								37
								38
								39
								40

.271

## Accounts Receivable - Lead Sheet

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Work paper ref	Account titles					Client's acct. no.	Final Bal.
1							
2			Trade accounts receivable, gross				
3							
4			Less allowances for				
5							
6			- Discounts				
7							
8			- Credits				
9							
10							
11			subtotal				
12							
13			Less, allowance for doubtful accts.				
14							
15			Trade receivables, net				
16							
17			Other receivables:				
18							
19			(Describe individual accounts, if more				
20			practical, list them on a separate sheet				
21			as either page two of this lead sheet or				
22			as a separate lead sheet with a separate				
23			grouping of working papers)				
24							
25			Relationships - Sales and trade receivables				
26							
27			Gross sales,				
28			Less: discounts				
29			allowances				
30							
31			Net sales				
32							
33			Less: cash sales				
34							
35			Net account sales				
36							
37			Turnover ratios				
38							
39							
40							

**AAM § 6500.271**

ABC Co.

.280

Accts. Receivable - Confirm Statistics  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

		(1)	(2)	(3)	(4)	(5) Number of Accounts		(6) Dollars		(7)	(8)
						Count	Percent	Amount	Percent		
1	Confirm requests										1
2	Positives										2
3	Negatives										3
4	Total sent										4
5	Accts picked-client asked us not										5
6	to confirm (A) (B)										6
7	Total picked for testing					xxx(D)	yy(D)	xxxxxx(D)	zz(D)		7
8	Total accts rec at (insert										8
9	confirm date)					aaaaaa	100%	aaaaaa	100%		9
10	RESULTS - replies received										10
11	through (insert date)										11
12	Positives - no exception										12
13	Negatives - did not reply										13
14	or reported no exceptions										14
15											15
16	Differences reported & resolved										16
17	as no exceptions										17
18	Positive										18
19	Negative										19
20	Totals confirmed										20
21	Unanswered positives and accts										21
22	client asked us not to										22
23	confirm (B)										23
24	Total confirmed & tested										24
25	Differences found to be										25
26	potential adjustments										26
27	Positive replies										27
28	Negative replies										28
29	Total (C)										29
30	Totals selected for testing					xxx(D)	yy(D)	xxxxxx(D)	zz(D)		30
31											31
32	(A) See W.P. (ref _____) on accts client asked us not to confirm &										32
33	disposition.										33
34	(B) See W.P. (ref _____) on alt means procedures and results.										34
35	(C) See W.P. (ref _____) on conclusions reached and proposed disp.										35
36	(D) These two lines present identical data for balancing purposes.										36
37											37
38	NOTE:										38
39											39
40	(A) Comparative summaries of confirmation results in carryforward										40
	working papers may be informative and useful.										

## .281 Accts. Receivable - Confirm Statistics

	Initials	Date
Prepared By		
Approved By		

		(1)	(2)	(3)	(4)	(5) Number of Accounts		(6) Dollars	
						Count	Percent	Amount	Percent
1	Confirm requests								
2	Positives								
3	Negatives								
4	Total sent								
5	Accts picked-client asked us not								
6	to confirm (A) (B)								
7	Total picked for testing								
8	Total accts rec at (insert								
9	confirm date)								
10	RESULTS - replies received								
11	through (insert date)								
12	Positives - no exception								
13	Negatives - did not reply								
14	or reported no exceptions								
15									
16	Differences reported & resolved								
17	as no exceptions								
18	Positive								
19	Negative								
20	Totals confirmed								
21	Unanswered positives and accts								
22	client asked us not to								
23	confirm (B)								
24	Total confirmed & tested								
25	Differences found to be								
26	potential adjustments								
27	Positive replies								
28	Negative replies								
29	Total (C)								
30	Totals selected for testing								
31									
32	(A) See W.P. (ref _____) on accts client asked us not to confirm &								
33	disposition.								
34	(B) See W.P. (ref _____) on alt means procedures and results.								
35	(C) See W.P. (ref _____) on conclusions reached and proposed disp.								
36									
37									
38									
39									
40									

Accts Receivable - Reconciliation from Confirmation  
Date to Year End

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
			<u>12/31/X5</u>				
1	Balance	1/30/X5, confirm date			xxxxxx	(A)	
2							
3							
4	Add:	Sales			xxxxxx		
5							
6		Other (describe if any):			xxxx(D)		
7					xxxx		
8						xxxxxx	
9						xxxxxx	
10	Deduct:	Cash receipts			xxxxxx(B)		
11							
12		Credit memos			xxxxxx(C)		
13							
14		Other (describe if any):			xxxx(D)		
15					xxxx		
16						xxxxxx	
17	Balance per books	12/31/X5				xxxxxx	
18							
19	Adjustments (describe if any):						
20							
21		Final balance				xxxxxx	
22							
23	NOTES:						
24							
25	(A)	Should be cross-referenced to working paper summarizing or scheduling total of subsidiary detail used for confirmation selections.					
26							
27							
28							
29	(B)	Should be traced to source, such as sales journal and cash receipts journal.					
30							
31							
32	(C)	Depending on the circumstances, it may be necessary to segregate by such types of credits as adjustments of selling prices and returns of shipments.					
33							
34							
35							
36	(D)	There are various possibilities. For example, the client may make adjustments based on the auditor's findings during preliminary work, or adjustments to resolve certain differences disclosed by the confirmation procedures.					
37							
38							
39							
40							

.291

**Accts Receivable - Reconciliation from Confirmation**  
**Date to Year End**

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1								
2	Balance	11/30/X5,	confirm date					
3								
4	Add:	Sales						
5								
6		Other (describe if any):						
7								
8								
9								
10	Deduct:	Cash receipts						
11								
12		Credit memos						
13								
14		Other (describe if any):						
15								
16								
17	Balance per books	12/31/X5						
18								
19	Adjustments (describe if any):							
20								
21		Final balance						
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								



ABC Co.

.300

Accts. Rec. - Review of Post Bal. Sheet Cr. Memos

12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Name of Customer			Credit Memo Date No. Amount		Description		
1							1
2							2
3							3
4							4
5							5
6							6
7							7
8							8
9							9
10							10
11							11
12							12
13							13
14							14
15							15
16							16
17							17
18							18
19							19
20							20
21							21
22							22
23							23
24							24
25							25
26							26
27							27
28							28
29							29
30							30
31							31
32							32
33							33
34							34
35							35
36							36
37							37
38							38
39							39
40							40

NOTE:

(A) Reviewed sales journal for 1/1/X6 through (indicate date) and examined all credit memos of \$XXX and over. Also reviewed file of unposted memoranda on (indicate date) and examined all credit memos of \$XXX and over.

.301

Accts. Rec. - Review of Post Bal. Sheet Cr. Memos

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Name of Customer			Credit Memo Date No.	Amount	Description		
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

**NOTE:**

Reviewed sales journal for \_\_\_\_\_ through \_\_\_\_\_  
 and examined all credit memos of \_\_\_\_\_ and over. Also  
 reviewed file of unposted memoranda on (indicate date)  
 and examined all credit memos of \_\_\_\_\_ and over.

ABC Company

.310

## Confirmation Control Sheet (A)

12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
Confirm. Control No.	Name of Company	1st Request		2nd Request		Date Sent	Date Received	
		Date Sent	Date Received	Date Sent	Date Received			
1							1	
2							2	
3							3	
4							4	
5							5	
6							6	
7							7	
8							8	
9							9	
10							10	
11							11	
12							12	
13							13	
14							14	
15							15	
16							16	
17							17	
18							18	
19							19	
20							20	
21							21	
22							22	
23							23	
24							24	
25	NOTE:						25	
26	(A)	There are various approaches to controlling confirmation procedures. Some auditors may use copies of the confirmation letters to control positive confirmation requests and use a symbol and legend on a schedule, tape or aging analysis to indicate balances selected for confirmation and the type of response received.						26
27								27
28								28
29								29
30								30
31								31
32								32
33								33
34								34
35								35
36								36
37								37
38								38
39								39
40								40

.311

## Confirmation Control Sheet

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Confirm. Control No.	Name of Company	1st Request				2nd Request	
		Date Sent	Date Received	Date Sent	Date Received		
1							
2							
3							
4							
5							
6							
7							
8							
9							
10							
11							
12							
13							
14							
15							
16							
17							
18							
19							
20							
21							
22							
23							
24							
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

ABC Company

.320

Accts. Receivable - Aging Analysis (A)  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Name of customer	(B)	Total bal per sub. ledger	Current 1-30 days	31-60 days	Past Due 61-90 days	Over 90 days	
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15	Aging Analysis Totals (B)							
16								
17	Percentage analysis of aging			100%	xx%	xx%	xx%	xx%
18								
19								
20								
21								
22	NOTES:							
23								
24	(A) This analysis is often prepared by clients for internal pur-							
25	poses. If practical, the auditor may save time by using a							
26	copy of the client's schedule for working paper purposes.							
27	The auditor may need to modify his (her) copy of the client's							
28	schedule by adding additional columns or pasting the copy on							
29	to a format similar to this illustration.							
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
Remarks				Allowance needed (C)			
				Explanation		Amount	
							1
							2
							3
							4
							5
							6
							7
							8
							9
							10
							11
							12
							13
							14
							15
							16
							17
							18
							19
							20
<u>NOTES</u> (continued)							21
							22
							23
(B)	Depending on the circumstances (internal control structure, relative number of customer accounts and significance of individual balances) the auditor may include any of the following in the working papers:						24
							25
(i)	copy of the complete aging analysis.						26
(ii)	detail aging analysis of only those customer accounts with balances over a predetermined dollar amount and summary amounts for aging of accounts with balances equal to and lesser than the predetermined amount.						27
							28
(iii)	summary of the aging analysis totals and other schedules and narratives to describe detail testing.						29
							30
							31
							32
							33
(C)	These columns are used when individual customer balances may be large enough in relation to the total receivables balance for review on a specific account basis to determine the need for allowances.						34
							35
							36
							37
							38
							39
							40

**NOTES (continued)**

- (B) Depending on the circumstances (internal control structure, relative number of customer accounts and significance of individual balances) the auditor may include any of the following in the working papers:
- (i) copy of the complete aging analysis.
  - (ii) detail aging analysis of only those customer accounts with balances over a predetermined dollar amount and summary amounts for aging of accounts with balances equal to and lesser than the predetermined amount.
  - (iii) summary of the aging analysis totals and other schedules and narratives to describe detail testing.
- (C) These columns are used when individual customer balances may be large enough in relation to the total receivables balance for review on a specific account basis to determine the need for allowances.

.321

## Accts. Receivable - Aging Analysis

Prepared By	Initials	Date
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Name of customer		Total bal per sub. ledger	Current 1-30 days	31-60 days	Past Due 61-90 days	Over 90 days	
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15	Aging Analysis Totals							
16								
17	Percentage analysis of aging			%	%	%	%	%
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

(10) Remarks										(11) Allowance needed									



ABC Company

.330

Accounts Receivable - Other  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Due from	Explanation	Final bals. 12/31/X4	Balances Per client	12/31/X5 AJEs Dr (Cr)	Final	
1			(A)	(A)			1
2	Describe individual components deemed significant enough for application of auditing procedures.						2
3							3
4							4
5							5
6							6
7							7
8							8
9							9
10							10
11		Subtotal					11
12							12
13	Other (B)						13
14	Total						14
15							15
16	NOTES:						16
17							17
18							18
19							19
20	(A) The comparative columns are provided for review and explanation of fluctuations.						20
21							21
22							22
23							23
24	(B) Components which total to an amount believed not significant enough to merit audit attention may be grouped as one amount.						24
25							25
26							26
27							27
28							28
29							29
30							30
31							31
32							32
33							33
34							34
35							35
36							36
37							37
38							38
39							39
40							40

.331

Accounts Receivable - Other

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Due from	Explanation	Final bals.	Balances Per client	AJEs Dr (Cr)	Final		
1							
2	Describe individual components						
3	deemed significant enough for						
4	application of auditing						
5	procedures.						
6							
7							
8							
9							
10							
11		Subtotal					
12							
13	Other						
14	Total						
15							
16							
17							
18							
19							
20							
21							
22							
23							
24							
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

ABC Co.

Date

Prepared By

Work  
Paper No.

Reviewed By

## 332 Accounts Receivable - Analytical Procedures

12/31/X5											
G/L	A/C	Balance		Balance		Difference		W/P Ref Follow			
No.		12/31/X4		12/31/X5				Up Of Material		Differences	
1		Accounts Receivable - Gross									
2		Sales - Gross									
3											
4											
5											
6											
7											
8											
9	Ratio Analysis"	19X4		19X5							
10											
11	No. of Days Net Sales										
12	in Trade Accounts Receivable:										
13	Trade A/R										
14	Sales/365										
15											
16	Year End Trade Accounts										
17	Receivable As A Percentage										
18	Of Gross Sales:										
19	Trade A/R										
20	Sales										
21											
22	A/R Turnover:										
23	Credit Sales										
24	Average A/R										
25											
26	A/R Collection Period										
27	365 Days										
28	A/R Turnover										
29											
30											
31											
32											
33											
34											
35											
36											
37											
38											
39											
40											

## .333 Accounts Receivable - Analytical Procedures

Date	Prepared By	Work Paper No.
	Reviewed By	

1	2	3	4	5	6	7
G/L	A/C		Balance	Balance	Difference	W/P Ref Follow
No.						Up Of Material
						Differences
1		Accounts Receivable - Gross				
2		Sales - Gross				
3						
4						
5						
6						
7						
8						
9		Ratio Analysis				
10						
11		No. of Days Net Sales				
12		in Trade Accounts Receivable:				
13		$\frac{\text{Trade A/R}}{\text{Sales}/365}$				
14						
15						
16		Year End Trade Accounts				
17		Receivable As A Percentage				
18		Of Gross Sales:				
19		$\frac{\text{Trade A/R}}{\text{Sales}}$				
20						
21						
22		A/R Turnovers:				
23		$\frac{\text{Credit Sales}}{\text{Average A/R}}$				
24						
25						
26		A/R Collection Period				
27		$\frac{365 \text{ Days}}{\text{A/R Turnover}}$				
28						
29						
30						
31						
32						
33						
34						
35						
36						
37						
38						
39						
40						

ABC Company

.340

Allowance for Doubtful Accounts - Related Expense  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
	Description	Final Balance 12/31/X4	Prov. for Expense	Activity 19X5 Write offs	Recoveries	Bal 12/31/X5			
1									1
2	If there are sig-								2
3	nificant indivi-								3
4	dual components,								4
5	describe or								5
6	cross reference								6
7	to a supporting								7
8	paper that pre-								8
9	sents particu-								9
10	lars.								10
11									11
12									12
13									13
14									14
15									15
16	Totals per client	xxxxx	xxxxx	(xxx xx)	xxx x	xxxxx			16
17									17
18	Adjustments:								18
19	(describe)		xxxx			xxxx			19
20									20
21	Final	xxxxx	xxxx	(xxxxxx)	xxxx	xxxxx			21
22									22
23									23
24									24
25									25
26									26
27									27
28									28
29									29
30									30
31									31
32									32
33									33
34									34
35									35
36									36
37									37
38									38
39									39
40									40

.341

## Allowance for Doubtful Accounts - Related Expense

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Description	Final Balance	Prov. for Expense	Activity Write offs	Recoveries	Bal		
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16	Totals per client							
17								
18	Adjustments:							
19	(describe)							
20								
21	Final							
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

ABC Company

.350

Allowance for Doubtful Accounts, Provisions,  
Write Offs and Recoveries

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
			Carryforward Analysis (A)					
1								
2		1	Balance, beginning of year					
3								
4		2	Add: Provision					
5								
6		3	Less: Balance, end of year					
7								
8		4	Net write offs for year					
9								
10		5	Add back recoveries restored to allowance (B)					
11								
12		6	Gross write offs					
13								
14								
15		7	Account (credit) sales for year					
16								
17		8 a	Trade accounts receivable					
18		8 b	Trade notes receivable					
19		8 c	Total trade accts. & notes receivable					
20								
21								
22		9	Receivables turnover (line 7 divided by line 8c)					
23								
24								
25		10	Average collection period in days (360 divided by line 9) (C)					
26								
27								
28		11	Net write offs as % of acct. sales (line 4 divided by line 7)					
29								
30		12	Allowance as % of receivables (line 3 divided by line 8c)					
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
19X0	19X1	19X2	19X3	19X4	19X5	19X6	
xxxx							1
xxxx							2
xxxx							3
xxxx	NOTES:						4
(xxxx)	(A)	Depending on the circumstances, an auditor may find it useful to maintain continuing analysis of the allowance for doubtful accounts and related activity. For clients with a small number of significant trade accounts receivable, an auditor may decide it is more practical to review each balance individually and may consider this type of schedule as unnecessary.					5
xxxx							6
xxx							7
xxxx							8
xxxx	(B)	In this illustration, it is assumed that recoveries of accounts written off are restored to the allowance.					9
360000							10
29000	(C)	A 360 day year was used in this illustration to simplify computations.					11
1000							12
30000							13
							14
							15
							16
							17
							18
							19
							20
12							21
							22
							23
30 days							24
							25
							26
xx%							27
							28
xx%							29
							30
							31
							32
							33
							34
							35
							36
							37
							38
							39
							40



.351

**Allowance for Doubtful Accounts, Provisions,  
Write Offs and Recoveries**

Prepared By	Initials	Date
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	<b>Carryforward Analysis</b>							
1								
2	1	Balance, beginning of year						
3								
4	2	Add: Provision						
5								
6	3	Less: Balance, end of year						
7								
8	4	Net write offs for year						
9								
10	5	Add back recoveries restored to allowance						
11								
12	6	Gross write offs						
13								
14								
15	7	Account (credit) sales for year						
16								
17	8 a	Trade accounts receivable						
18	8 b	Trade notes receivable						
19	8 c	Total trade accts. & notes receivable						
20								
21								
22	9	Receivables turnover (line 7 divided by line 8c)						
23								
24								
25	10	Average collection period in days (360 divided by line 9)						
26								
27								
28	11	Net write offs as % of acct. sales (line 4 divided by line 7)						
29								
30	12	Allowance as % of receivables (line 3 divided by line 8c)						
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

**AAM § 6500.351**

ABC Co.

.352 Allowance for Doubtful A/C's - Analytical Procedures

Date	Prepared By	Work Paper No.
	Reviewed By	

1	2	3	4	5	6	7
			Balance	Balance		W/P Ref Follow
	G/L A/C		12/31/X4	12/31/X5	Difference	Up Of Material
	No.					Differences
1		Allowance - Doubtful A/C's				
2		Bad Debt Provision				
3		Sales - Returns & Allowances				
4						
5						
6						
7						
8		Ratio Analysis:	19X4	19X5		
9						
10		Sales Returns/Gross Sales				
11						
12		Bad Debt Provision/Gross Sales				
13						
14		Allowance/Accounts Receivable				
15						
16						
17						
18						
19						
20						
21						
22						
23						
24						
25						
26						
27						
28						
29						
30						
31						
32						
33						
34						
35						
36						
37						
38						
39						
40						

## 353 Allowance for Doubtful A/C's - Analytical Procedures

Date	Prepared By	Work Paper No
	Reviewed By	

1		2		3		4		5		6		7	
G/L A/C				Balance		Balance		Difference		W/P Ref Follow		Up Of Material	
No.												Differences	
1		Allowance - Doubtful A/C's											
2		Bad Debt Provision											
3		Sales - Returns & Allowances											
4													
5													
6													
7													
8		Ratio Analysis:											
9													
10		Sales Returns/Gross Sales											
11													
12		Bad Debt Provision/Gross Sales											
13													
14		Allowance/Accounts Receivable											
15													
16													
17													
18													
19													
20													
21													
22													
23													
24													
25													
26													
27													
28													
29													
30													
31													
32													
33													
34													
35													
36													
37													
38													
39													
40													

ABC Company

.360

Inventories - Lead Sheet  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
W.P. Ref	Account title (B)	Account No.	Final 12/31/X4	Per Client 12/31/X5	Adjust- ments(A) Dr (Cr)	as ad- justed 12/31/X5	
1	Raw materials						1
2							2
3							3
4	Work in process						4
5							5
6	Finished goods						6
7							7
8	Supplies						8
9							9
10							10
11							11
12	Cost of sales (C)						12
13	Ratios (describe) (D)						13
14							14
15							15
16	<u>NOTES:</u>						16
17	(A) This paper may be expanded for such purposes as providing						17
18	additional columns for reclassifications, and using sep-						18
19	arate debit and credit columns for adjustments.						19
20	(B) These account titles might be far more complex than the						20
21	above. Work-in-process accounts, for example, might be						21
22	expanded to identify separate processes, departments or						22
23	plants.						23
24	(C) It may be useful to also present data from related expense						24
25	accounts and selected ratio analyses on the inventory						25
26	lead sheet.						26
27	(D) Some firms require that the lead sheet also include the						27
28	auditor's individual conclusions on the audit objectives,						28
29	work done and resulting findings.						29
30							30
31							31
32							32
33							33
34							34
35							35
36							36
37							37
38							38
39							39
40							40

.361

## Inventories - Lead Sheet

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
W.P. Ref	Account title	Account No.	Final	Per Client	Adjust- ments(A) Dr (Cr)	as ad- justed	
1	Raw materials						
2							
3							
4	Work in process						
5							
6	Finished goods						
7							
8	Supplies						
9							
10							
11							
12	Cost of sales						
13	Ratios (describe)						
14							
15							
16							
17							
18							
19							
20							
21							
22							
23							
24							
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

ABC Company

.370

Inventory - Analysis from Physical to Year End (A)  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
					Raw Materials	Work in Process	Finished Goods	Supplies
1								
2	Balance per books 11/30/X5				xxxxxx	xx xxx	xxxxxx	xxxxx
3	Adjustment of books to physical (B)				xxxx	( xxx )	(xxx	xxxx
4	Per physical 11/30/X5				xxxxxx	xx xxx	xxx xxx	xxxxx
5								
6	December 19X5 activity							
7								
8	Purchases-raw materials-supplies				xxxxxx			xxx
9	Requisitions-				(xxxxxx)	xxxxx		( xxx )
10	Direct labor					xxxxxx		
11	Overhead					xxxxxx		
12						xxxxxx		
13	Cost of goods manufactured					(xxxxxx)	xxxxxx	
14							xxxxxx	
15	Cost of goods sold						(xxxxxx)	
16								
17	Other (describe)							
18								
19	Balance 12/31/X5				xxxxxx	xxxxxx	xxxxxx	xxxxx
20								
21								
22								
23								
24								
25	NOTES:							
26	(A)	This type of analysis will vary greatly with the circumstances.						
27		For example, some clients may use several general ledger accounts						
28		for production and inventory while others may have a small number						
29		of general ledger controlling accounts that are tied to a detailed						
30		cost accounting system. Other obvious variables include the fol-						
31		lowing:						
32		• Assumptions on the flow of cost (FIFO, LIFO, etc.).						
33		• Method of cost accounting (process, job order, direct costing						
34		for internal reports and adjustment to absorption costing for						
35		external reporting, standard costs, retail method, etc.).						
36	(B)	Adjustment may be more complex than a simple difference between						
37		the book balances and the priced physical inventory. This may re-						
38		quire a separate analysis of adjustments to the inventory per books						
39		and/or the physical.						
40								

.371

## Inventory - Analysis from Physical to Year End

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
					Raw Materials	Work in Process	Finished Goods	Supplies
1								
2	Balance per books							
3	Adjustment of books to physical							
4	Per physical							
5								
6		activity						
7								
8	Purchases-raw materials-supplies							
9	Requisitions-							
10	Direct labor							
11	Overhead							
12								
13	Cost of goods manufactured							
14								
15	Cost of goods sold							
16								
17	Other (describe)							
18								
19	Balance							
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								



## ABC Company

.380

Inventory - Test Counts 11/30/X5 (A) (B)  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Ticket No. or other ref.	Location & Description [Part #] (B)			Count per Client	Auditor	Difference test over (under) client	
1	(B)	Department A					1
2							2
3	xxxx	xxxX xxxxxx		xx	xx	—	3
4							4
5	xxxx	xxxx xxxxxx		xx	xx	x	5
6							6
7	xxxx	xxxx xxxxxx		xx	xx	( x )	7
8							8
9		Department B					9
10							10
11	xxxx	xxxX xxxxxx		xxx	xxx	—	11
12							12
13	xxxx	xxxx xxxxxx		xxx	xxx	—	13
14							14
15							15
16							16
17	NOTES:						17
18	(A)	The design of test count work sheets will depend on the circumstances and may vary extensively from the above which is assumed to involve simple unit counts. Other physical inventories, for example, may involve conversion of units to weight, surveys of volume with conversion to tonnage, or special techniques such as engineering surveys of volume, aerial photography, and chemical analyses.					18
19							19
20							20
21	(B)	For each item, the location, reference, description and other data must provide sufficient detail for subsequent tracing of the auditor's test counts or observations into the client's compilation and summarization of its physical inventory. Accordingly, advance planning is extremely important in preparing for observation and testing of a client's physical inventory. Provision should be made for inclusion in the working papers of such information as number of tickets used, unused and voided, or the number of count sheets used.					21
22							22
23							23
24							24
25							25
26							26
27							27
28							28
29							29
30							30
31							31
32							32
33							33
34							34
35							35
36							36
37							37
38							38
39							39
40							40

.381

## Inventory - Test Counts

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Ticket No. or other ref.	Location & Description (Part #)			Count per Client	per Auditor	Difference test over (under) client	
1							
2							
3							
4							
5							
6							
7							
8							
9							
10							
11							
12							
13							
14							
15							
16							
17							
18							
19							
20							
21							
22							
23							
24							
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

ABC Company

.390

Inventory Price Test - Raw Materials (A)  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Ref. to Physical	Description (including part number)	Per Phys. Inventory		Unit	Name of Vendor		
	(B)		Dollar Amt	Quantity	Price			
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16		Recap of dollar coverage						
17								
18		Total dollars tested			%			
19								
20		Total dollar amount of						
21		raw materials inven-						
22		tory			100 %			
23								
24		NOTES:						
25		(A) The approach and resulting working papers for price testing will						
26		vary with the circumstances (for example, if ABC priced its in-						
27		ventory at standard costs, and/or used LIFO).						
28		(B) This column provides for practical cross reference to the client's						
29		physical inventory as priced, extended and summarized. Examples						
30		include page numbers, ticket or tag numbers, etc.						
31		(C) Prices for test purposes are from most recent invoices (including						
32		related shipping expense) for an appropriate quantity.						
33		(D) Consideration of individual differences and their aggregate ef-						
34		fect is a matter for the auditor's judgment in the circumstances.						
35		The auditor should be mindful of ARB No. 43, Chapt. 4 on inventory						
36		pricing.						
37								
38								
39								
40								

(9)			(10)			(11)			(12)			(13)			(14)			(15)			(16)		
Price Test (C)									Diff., test is over (under) phys.			Dollar effect of diff. on inventory			Remarks (D)								
Date	Invoice or Vou No	Quantity	Unit price																				
																					1		
																					2		
																					3		
																					4		
																					5		
																					6		
																					7		
																					8		
																					9		
																					10		
																					11		
																					12		
																					13		
																					14		
																					15		
																					16		
																					17		
																					18		
																					19		
																					20		
																					21		
																					22		
																					23		
																					24		
																					25		
																					26		
																					27		
																					28		
																					29		
																					30		
																					31		
																					32		
																					33		
																					34		
																					35		
																					36		
																					37		
																					38		
																					39		
																					40		

.391

## Inventory Price Test - Raw Materials

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Ref. to Physical	Description (including part number)	Per Phys. Inventory Dollar Amt	Quantity	Unit Price	Name of Vendor		
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16		Recap of dollar coverage						
17								
18		Total dollars tested			\$			
19								
20		Total dollar amount of						
21		raw materials inven-						
22		tory			\$			
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

**[The next page is 6623.]**



## Inventory Price Tests of Work-in-Process and Finished Goods—General Note on Working Papers

.400 The working paper formats for price tests of work-in-process and finished goods inventories will vary with the circumstances of individual engagements. Among the variables are the following:

- The client's particular industry and business.
- Cost accounting method (job order or process cost, use of standard costs, application of overhead costs, retail method).
- Assumptions about flow of costs (FIFO, LIFO, moving average).
- Other cost accounting matters such as allocation of costs to various products included in inventories.

Because of the many complex variables involved, sample working papers on price tests of work-in-process and finished goods inventory are not presented. However, the following possible column headings may be useful in considering working paper formats for price tests of specific items of work-in-process and finished goods inventory:

Part number or product code

Job order number

Description

Department or plant location

Quantity in inventory

Date produced (is it slow-moving or obsolete?)

Material cost

Labor cost

Overhead cost

Total cost

Unit cost

Inventory dollar amount

Status (stage of completion, process code no., etc.)

Recent actual job order cost

Recent process or standard unit cost

Recent actual selling price and gross profit percentage (is it adequate?)

Recent sales volume (is item slow-moving or obsolete?)

Depending on the circumstances, it may be more efficient to use copies of the client's analyses and prepare supplementary schedules rather than develop completely separate analysis formats.



ABC Co.

## .401 Inventories - Analytical Procedures

Date	Prepared By	Work Paper No.
	Reviewed By	

12/31/X5																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																
										Balance																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																						
G/L A/C										12/31/X4										12/31/X5										Difference										W/P Ref.																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																								
																																								Follow Up Of																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																								
																																								Material																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																								
																																								Differences																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																								
1																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																																

## .402 Inventories -- Analytical Procedures

Date	Prepared By	Work Paper No.
	Reviewed By	

	G/L A/C		Balance		Difference		W/P Ref.
							Follow Up Of Material Differences
1							
2							
3							
4							
5							
6							
7							
8							
9							
10							
11							
12							
13							
14							
15							
16							
17							
18							
19							
20							
21							
22							
23							
24							
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

ABC Company

.410

Prepaid Insurance and Related Expense (A)

12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Company		Pol No		Coverage		Amt	Coinsur- ance
					Type			
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20	NOTES							
21	(A) The column headings of this analysis may also be those of the							
22	client's insurance register. It may be practical for the client							
23	to prepare this schedule as a time saver.							
24	(B) If the schedule includes insurance costs that are expensed en-							
25	tirely in the year incurred, the column for insurance expense							
26	should support the balance in the client's insurance expense							
27	account(s).							
28	(C) The opening balance would be the final balance per the preceding							
29	year's working papers.							
30	(D) The adjustment(s) should be adequately explained; a symbol and							
31	footnote may suffice.							
32								
33								
34								
35								
36								
37								
38								
39								
40								

(9)		(10)		(11)	(12)	(13)	(14)	(15)	(16)	
Terms of Coverage		Original		Monthly	Ppd Ins.	19X5 Activity (B)		Ppd Ins.		
From	To	Premium		Amorti-	bal.	Payments	Insurance	bal.		
				zation	12/31/X4	(refunds)	Expense	12/31/X5		
					(C)					1
										2
										3
										4
										5
										6
										7
										8
										9
										10
										11
										12
										13
										14
				Totals						15
				Adjustment (D)				(xxx)	(xx x)	16
				Final						17
										18
										19
										20
										21
										22
										23
										24
										25
										26
										27
										28
										29
										30
										31
										32
										33
										34
										35
										36
										37
										38
										39
										40

.411

## Prepaid Insurance and Related Expense

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Company		Pol No	Coverage Type		Amt	Coinsur- ance	Policy Date
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

**AAM § 6500.411**

ABC Company

.420

Prepaid Insurance (Alternative Format)  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
				Total A/C # XXX	XYZ Fire Ins Co.	XYZ Casualty Co.	Blanket Insurance Co.	
1								1
2	Policy numbers							2
3								3
4	Coverages:							4
5	Types							5
6								6
7								7
8								8
9	Amount							9
10								10
11								11
12								12
13	Book value of assets							13
14	insured							14
15								15
16	Terms of coverage							16
17	From							17
18	To							18
19								19
20	Premium amount							20
21	Monthly write-off							21
22								22
23	Prepaid bal 12/31/X4							23
24								24
25	Additions							25
26								26
27	Expense							27
28								28
29	Prepaid bal 12/31/X5							29
30								30
31								31
32								32
33								33
34								34
35								35
36								36
37								37
38								38
39								39
40								40

.421

## Prepaid Insurance

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Total A/C #							
1								
2	Policy numbers							
3								
4	Coverages:							
5	Types							
6								
7								
8								
9	Amount							
10								
11								
12								
13	Book value of assets							
14	insured							
15								
16	Terms of coverage							
17	From							
18	To							
19								
20	Premium amount							
21	Monthly write-off							
22								
23	Prepaid bal							
24								
25	Additions							
26								
27	Expense							
28								
29	Prepaid bal							
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								



ABC Company

.430

Property Taxes - Prepaid & Accrued (A)  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	← Property →							
	Taxing Organization Location & description					Assessed Value	Total Tax	Payment date
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

## NOTES:

- (A) This analysis may support prepaid expenses included among assets, accrued taxes included among liabilities and tax expenses. The auditor's preference determines whether this analysis is filed among papers on assets, liabilities or expenses. However, the amounts should be cross-referenced with their location in lead sheets that support all relevant statement groupings.
- (B) The column for expenses incurred may include write-offs of prepaid amounts and provisions for amounts incurred but not yet paid. This will depend on the timing of the payment due dates and periods covered for each taxing organization.

(9)		(10)		(11)		(12)		(13)		(14)		(15)		(16)	
Period		Covered		Final Bal		12/31/X4		19X5 Activity		Bal 12/31/X5					
From		To		Prepaid		Accrued		Payments		Expense incurred (B)		Prepaid		Accrued	
															1
															2
															3
															4
															5
															6
															7
															8
															9
															10
															11
															12
															13
															14
															15
															16
															17
															18
															19
															20
															21
															22
															23
															24
															25
															26
															27
															28
															29
															30
															31
															32
															33
															34
															35
															36
															37
															38
															39
															40

.431

## Property Taxes - Prepaid &amp; Accrued

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Property							
	Taxing Organization Location & description					Assessed Value	Total Tax	Payment date
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

**AAM § 6500.431**

ABC Company

.440

Prepaid expenses - other  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Acct No.	Description	Period covered From To	Bal 12/31/X4	Additions	Charges to expense	Bal 12/31/X5	
1							1
2							2
3							3
4							4
5							5
6							6
7							7
8							8
9							9
10							10
11							11
12							12
13							13
14							14
15							15
16							16
17							17
18							18
19							19
20							20
21							21
22							22
23							23
24							24
25							25
26							26
27							27
28							28
29							29
30							30
31							31
32							32
33							33
34							34
35							35
36							36
37							37
38							38
39							39
40							40

.441

## Prepaid expenses - other

	Initials	Date
Prepared By		
Approved By		

(1)		(2)			(3)			(4)		(5)		(6)		(7)		(8)	
Acct No.		Description			Period covered			From To		Bal		Additions		Charges to expense		Bal	
1																	
2																	
3																	
4																	
5																	
6																	
7																	
8																	
9																	
10																	
11																	
12																	
13																	
14																	
15																	
16																	
17																	
18																	
19																	
20																	
21																	
22																	
23																	
24																	
25																	
26																	
27																	
28																	
29																	
30																	
31																	
32																	
33																	
34																	
35																	
36																	
37																	
38																	
39																	
40																	

.442 ABC Co.

## Prepaid Expenses - Analytical Procedures

Date	Prepared By	Work Paper No.
	Reviewed By	

12/31/X5																	
1		2		3		4		5		6		7					
G/L A/C						Balance		Balance				W/P Ref Follow					
No.						12/31/X4		12/31/X5		Difference		Up of Material					
												Differences					
1																	
2																	
3																	
4																	
5																	
6																	
7																	
8																	
9																	
10																	
11																	
12																	
13																	
14																	
15																	
16																	
17																	
18																	
19																	
20																	
21																	
22																	
23																	
24																	
25																	
26																	
27																	
28																	
29																	
30																	
31																	
32																	
33																	
34																	
35																	
36																	
37																	
38																	
39																	
40																	

### Prepaid Expenses - Analytical Procedures

Date	Prepared By	Work Paper No.
	Reviewed By	

G/L A/C		Balance	Balance	Difference	W/P Ref Follow
No.					Up of Material Differences
1					
2					
3					
4					
5					
6					
7					
8					
9					
10					
11					
12					
13					
14					
15					
16					
17					
18					
19					
20					
21					
22					
23					
24					
25					
26					
27					
28					
29					
30					
31					
32					
33					
34					
35					
36					
37					
38					
39					
40					



.450

ABC Company  
Deposits & Miscellaneous Current Assets  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
Client's Acct No.	Description				Final Bal. 12/31/X4	Bal per client 12/31/X5	Adjust- ments Dr (Cr)	Final Bal. 12/31/X5
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20	NOTES:							
21	The comparative format may aid in review of fluctuations at the detail level.							
22								
23	Symbols and legends may be used to indicate confirmation and/or other procedures applied, and as cross-references to explanatory notes if required, concerning individual balances or disposition of prior year balances.							
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

.451

*Deposits & Miscellaneous Current Assets*

	Initials	Date
Prepared By		
Approved By		

(1)		(2)		(3)		(4)		(5)		(6)		(7)		(8)	
Client's Acct No.		Description				Final Bal.		Bal per client		Adjust- ments Dr (Cr)		Final Bal.			
1															
2															
3															
4															
5															
6															
7															
8															
9															
10															
11															
12															
13															
14															
15															
16															
17															
18															
19															
20															
21															
22															
23															
24															
25															
26															
27															
28															
29															
30															
31															
32															
33															
34															
35															
36															
37															
38															
39															
40															

.460

ABC Company

Property, Plant & Equipment, & Rel Depcn-Lead Analysis (C)  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Classification			ASSETS (A)				
			Final Bal 12/31/X4	Additions	Retire- ments & disposi- tions	Other Dr (Cr)	Bal 12/31/X5
1							
2	Land		xx xxx				xx xxx
3							
4	Buildings		xxx xxx				x xx xxx
5							
6	Machinery & equipment		xxxxxx	xxxx	xxxx		xxx xxx
7							
8	Furniture & fixtures		xx xxx	xxx	xx x		x xx xx
9							
10	Automobiles		xxxxx	xxxx	xxxx		xxxxx
11							
12	Leasehold improvements		xxxx			( xxx )	xx xx
13							
14							
15			xxx xxx	xxxx	x xx	( xxx )	x xxx xx
16							
17							
18							
19							
20							
21							
22							
23							
24							
25							
26	NOTES:						
27	(A) Some auditors may prefer to split this information into two						
28	analyses, ie: (1) property plant & equipment asset accounts, and						
29	(2) Accumulated depreciation. Some auditors may also expand the						
30	analysis to show separate line items for various depreciable lives.						
31	(B) This lead analysis, in addition to supporting the financial state-						
32	ments, can be tailored to group information needed if the client						
33	is required to file reports with regulatory agencies.						
34	(C) This information on distribution of depreciation and amortization						
35	could be shown elsewhere in other working papers with only a cross-						
36	reference shown here.						
37							
38							
39							
40							

(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)	
W.P. Ref.	Deprecia- tion method & Life	Accumulated Depreciation- Final Bal. 12/31/X4	Amortization (A) Additions	Retire- ments & disposi- tions	Other	Bal 12/31/X5	W.P. Ref	
		xxxxx	xxxx			xxxxxx		1
								2
								3
		xxxxx	xxxx	xxxx		xxxxxx		4
								5
		xxxxx	xxxx	xxxx		xxxxxx		6
								7
		xxxx	xxxx	xxx		xxxx		8
								9
		xxxx	xxx	xxxx		xxxx		10
								11
								12
								13
								14
		xxxxx	xxxx	xxxx		xxxxxx		15
								16
	Add: depreciation and amortization (if any) credited directly against the asset balance		xxx					17
								18
								19
								20
	Total depreciation & amortization		xxxx (C)					21
								22
								23
	Depreciation & amortization distributed to:							24
								25
	Manufacturing costs		xxxx					26
	Selling expense		xxx					27
	Gen & administrative		xxx					28
			xxxx (C)					29
								30
								31
								32
								33
								34
								35
								36
								37
								38
								39
								40

## .461 Property, Plant &amp; Equipment, &amp; Rel Depcn-Lead Analysis

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Classification			ASSETS				
				Final Bal	Additions	Retire- ments & disposi- tions	Other Dr (Cr)	Bal
1								
2	Land							
3								
4	Buildings							
5								
6	Machinery & equipment							
7								
8	Furniture & fixtures							
9								
10	Automobiles							
11								
12	Leasehold improvements							
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

**AAM § 6500.461**

.470

ABC Company  
Property Plant & Equipment - Additions (A)  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Date	Ref	Vendor	Description			Depre- ciable Life	Cost
1							
2			Describe individual additions including				
3			whether item is new or used (B)				
4							
5							
6							
7							
8							
9							
10			Subtotal, additions of over XXX each				
11							
12			Other, each of XXX or less				
13							
14			Total additions (B)				
15							
16			<u>Analysis for investment credit (C):</u>				
17							
18			Deduct excess of used property over limitation (C)				
19							
20			Fraction for qualified portion				
21			Qualified amounts (C)				
22							
23							
24			NOTES:				
25							
26			(A) This illustration is assumed to support a particular				
27			category such as machinery and equipment which may in-				
28			clude property that qualifies for an investment tax				
29			credit. Some auditors may prefer to group all addi-				
30			tions on one schedule and use analysis columns to				
31			segregate amounts into such classifications as land,				
32			buildings, machinery and equipment. Then a separate				
33			analysis may be prepared concerning additions which				
34			qualify for the investment tax credit.				
35			(B) Depending on the circumstances, an auditor may have				
36			all additions listed or select a minimum dollar				
37			amount and have only those additions over that				
38			amount listed.				
39			(C) Auditors should carefully consider applicable income				
40			tax requirements.				

(9)	(10)	(11)	(12)	(13)	(14)	(15)	(16)
Not eligible	Total eligible	Analysis for Investment Credit by Depreciable Life (C)					
		New Eligible Property			Used Eligible Property		
		7 or more	5 to under 7	3 to under 5	7 or more	5 to under 7	3 to under 5
							1
							2
							3
							4
							5
							6
							7
							8
							9
							10
							11
							12
							13
							14
							15
							16
							17
					(	)	18
							19
			X2/3	X1/3		X2/3	20
							21
							22
							23
							24
							25
							26
							27
							28
							29
							30
							31
							32
							33
							34
							35
							36
							37
							38
							39
							40



.471

## Property Plant &amp; Equipment - Additions

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Date	Ref	Vendor	Description			Depre- ciable Life	Cost
1								
2				Describe individual additions including				
3				whether item is new or used				
4								
5								
6								
7								
8								
9								
10				Subtotal, additions of over each				
11								
12				Other, each of or less				
13								
14				Total additions				
15								
16				Analysis for investment credit:				
17								
18				Deduct excess of used property over limitation				
19								
20				Fraction for qualified portion				
21				Qualified amounts				
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

**AAM § 6500.471**

ABC Company

.480 Property Plant - Equipment - Retirements & Dispositions  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Date sold disposed	Classification & Description			Date acquired	Depreciation Method	Life	Cost
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26		NOTE:						
27								
28		The auditor may find it useful to use additional analysis						
29		columns to aid in such matters as tax return preparation.						
30		For example, columns may be used to distinguish ordinary and						
31		capital gains and losses, and to identify recapture, if any,						
32		of depreciation and/or investment tax credits.						
33								
34								
35								
36								
37								
38								
39								
40								

(9)			(10)			(11)			(12)			(13)			(14)			(15)			(16)		
Accum. depre- ciation			Net carrying value			Proceeds of disp.			Net gain or loss			See note											
																							1
																							2
																							3
																							4
																							5
																							6
																							7
																							8
																							9
																							10
																							11
																							12
																							13
																							14
																							15
																							16
																							17
																							18
																							19
																							20
																							21
																							22
																							23
																							24
																							25
																							26
																							27
																							28
																							29
																							30
																							31
																							32
																							33
																							34
																							35
																							36
																							37
																							38
																							39
																							40

.481 Property Plant - Equipment - Retirements &amp; Dispositions

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Date sold disposed	Classification & Description		Date acquired	Depreciation Method	Life		Cost
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

**AAM § 6500.481**

ABC Co.

## .482 Fixed Assets - Analytical Procedures

Date	Prepared By	Work Paper No.
	Reviewed By	

12/31/X5								Balance				Balance				W/P Ref Follow													
G/L A/C								12/31/X4				12/31X5				Difference													
No.																Up Of Material													
																Differences													
1				Building																									
2				Machinery & Equipment																									
3				Furniture & Fixtures																									
4				Fixed Assets - Capital																									
5				Lease																									
6				Accumulated Amortization -																									
7				Capital Leases																									
8				Accumulated Depreciation -																									
9				Building																									
10				Accumulated Depreciation -																									
11				Machinery & Equipment																									
12				Accumulated Depreciation -																									
13				Furniture & Fixtures																									
14				Depreciation Expense																									
15				Repairs & Maintenance																									
16																													
17																													
18				Ratio Analysis:																									
19																													
20				Depreciation - Building/Building (Cost)																									
21				Accum Depr - Building/Building (Cost)																									
22				Depreciation - M & E/M & E (Cost																									
23				Accum Depr - M & E/M & E (Cost)																									
24				Depreciation - F & E/F & F (Cost)																									
25				Accum Depr - F & F/F & F (Cost)																									
26				Depreciation - Cap Leases/Cap Leases																									
27				Accum Amort - Cap Leases/Cap Leases																									
28																													
29																													
30																													
31																													
32																													
33																													
34																													
35																													
36																													
37																													
38																													
39																													
40																													

## 483 Fixed Assets - Analytical Procedures

Date	Prepared By	Work Paper No.
	Reviewed By	

1		2		3		4		5		6		7	
G/L		A/C		Balance		Balance		Difference		W/P Ref Follow		Up Of Material	
No.												Differences	
1			Building										
2			Machinery & Equipment										
3			Furniture & Fixtures										
4			Fixed Assets - Capital										
5			Lease										
6			Accumulated Amortization -										
7			Capital Leases										
8			Accumulated Depreciation -										
9			Building										
10			Accumulated Depreciation -										
11			Machinery & Equipment										
12			Accumulated Depreciation -										
13			Furniture & Fixtures										
14			Depreciation Expense										
15			Repairs & Maintenance										
16													
17													
18			Ratio Analysis:										
19													
20			Depreciation - Building/Building (Cost)										
21			Accum Depr - Building/Building (Cost)										
22			Depreciation - M & E/M & E (Cost)										
23			Accum Depr - M & E/M & E (Cost)										
24			Depreciation - F & F/F & F (Cost)										
25			Accum Depr - F & F/F & F (Cost)										
26			Depreciation - Cap Leases/Cap Leases										
27			Accum Amort - Cap Leases/Cap Leases										
28													
29													
30													
31													
32													
33													
34													
35													
36													
37													
38													
39													
40													



.490

ABC Company  
Intangible Assets

12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Description	Balance 12/31/X4	Additions at cost	Deductions Charged to P&L	Deductions Charged to other A/Cs	Other Additions (Deductions)	Balance 12/31/X5
1							1
2	Describe significant individual components.						2
3							3
4							4
5							5
6							6
7							7
8							8
9							9
10							10
11							11
12							12
13							13
14							14
15							15
16	NOTE:	This type of analysis might be arranged as follows for carryforward purposes:					16
17							17
18							18
19							19
20		Total	Organization	Goodwill	Goodwill		20
21		intangibles	Costs	acq - XYZ Co.	acq - DEF Co.		21
22			12/31/X2	5/30/X3	4/1/X4		22
23	Date incurred						23
24	Amortizable life		60 months	10 years	40 years		24
25	Orig Cost incurred		xxxx	xxxxx	xxxx		25
26	Monthly charge		xx	xxx	xx		26
27	Annual charge		xxx	xxxx	xxx		27
28							28
29	Balance 12/31/X2	xxxx	xxxx				29
30	Additions	xx xxx		xxxxx			30
31	Amortization	xxxx	xxx	xxxxx			31
32	Bal 12/31/X3	xxxxxx	xxxx	xxxxx			32
33	Additions	xxxx			xxxx		33
34	Amortization	xxxx	xxx	xxx	xxx		34
35	Bal 12/31/X4	xxxxxx	xxxx	xxxxx	xxxx		35
36	Additions						36
37	Amortization	xxxxx	xxx	xxx	xxx		37
38	Bal 12/31/X5	xxxxxx	xxxx	xxxxx	xxxx		38
39							39
40							40

.491

*Intangible Assets*

	Initials	Date
Prepared By		
Approved By		

(1)		(2)		(3)		(4)		(5)		(6)		(7)		(8)	
Description		Balance		Additions at cost		Deductions Charged to P&L		Charged to other A/Cs		Other Additions (Deductions)		Balance			
1															
2															
3															
4															
5															
6															
7															
8															
9															
10															
11															
12															
13															
14															
15															
16															
17															
18															
19															
20															
21															
22															
23	Date incurred														
24	Amortizable life														
25	Orig Cost incurred														
26	Monthly charge														
27	Annual charge														
28															
29	Balance														
30	Additions														
31	Amortization														
32	Bal														
33	Additions														
34	Amortization														
35	Bal														
36	Additions														
37	Amortization														
38	Bal														
39															
40															

ABC Co.

Date	Prepared By	Work Paper No.
	Reviewed By	

## .492 Intangible Assets - Analytical Procedures

12/31/X5

	1	2	3	4	5	6	7
				Balance	Balance		W/P Ref Follow
	G/L A/C			12/31/X4	12/31/X5	Difference	Up Of Material
	No.						Differences
1		Intangible Assets					
2		Deferred Charges					
3		Accumulated Amortization					
4		R&D Expense					
5							
6							
7							
8							
9		Ratio Analysis:					
10							
11		R&D Expense/Sales					
12							
13							
14							
15							
16							
17							
18							
19							
20							
21							
22							
23							
24							
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

Date	Prepared By	Work Paper No
	Reviewed By	

## .493 Intangible Assets - Analytical Procedures

				Balance		Balance		Difference		W/P Ref Follow	
G/L A/C										Up Of Material	
No.										Differences	
1			Intangible Assets								
2			Deferred Charges								
3			Accumulated Amortization								
4			R&D Expense								
5											
6											
7											
8											
9			Ratio Analysis:								
10											
11			R&D Expense/Sales								
12											
13											
14											
15											
16											
17											
18											
19											
20											
21											
22											
23											
24											
25											
26											
27											
28											
29											
30											
31											
32											
33											
34											
35											
36											
37											
38											
39											
40											

ABC Company

.500

## Accounts Payable - Lead Sheet

	Initials	Date
Prepared By		
Approved By		

(1)		(2)	(3)	(4)	(5)		(6)	(7)	(8)	
Client's acct. no. or code		Acct title		Final bal 12/31/X4	← 12/31/X5			as ad- justed	Q.P. Ref.	
					Per client	AJEs (Dr) Cr				
1										
2		Trade accts payable								
3										
4		(If comprised of a group of general ledger account								
5		balances, list the individual accounts to show								
6		how they group to the total for trade accounts								
7		payable.)								
8										
9										
10		Other current payables								
11										
12		(It may be practical to include the groupings								
13		general ledger accounts for other current payables								
14		on the same lead sheet, especially if considera-								
15		tion is given to showing one balance sheet classi-								
16		fication for trade and other accounts payable.)								
17										
18										
19										
20										
21										
22										
23										
24										
25										
26										
27										
28										
29										
30										
31										
32										
33										
34										
35										
36										
37										
38										
39										
40										

.501

## Accounts Payable - Lead Sheet

	Initials	Date
Prepared By		
Approved By		

(1)		(2)		(3)	(4)	(5)		(6)	(7)	(8)	
Client's acct.no. or code		Acct title		Final bal		← Per client		AJEs (Dr) Cr	→ as ad- justed	W.P. Ref.	
1		Trade accts payable									
2											
3											
4											
5											
6											
7											
8											
9		Other current payables									
10											
11											
12											
13											
14											
15											
16											
17											
18											
19											
20											
21											
22											
23											
24											
25											
26											
27											
28											
29											
30											
31											
32											
33											
34											
35											
36											
37											
38											
39											
40											

## ABC Company

.510

Trade Accounts Payable - Schedule (A)  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Source:	Note (B)			Balance 12/31/X5		Remarks	
	Vendor						
1							1
2	XYZ Corp			xxxxx	(D)		2
3	TUV Industries			xxx			3
4	P&Q Company			xxxxx			4
5	L and Sons			xxx			5
6	John Doe Mfg			xxxxx			6
7							7
8	Other, each under						8
9	xxx dollars (NOTE (C))			xxxxx			9
10							10
11	Total			xxxxx			11
12							12
13							13
14							14
15							15
16							16
17							17
18							18
19							19
20							20
21	NOTES:						21
22							22
23	(A)	Many auditors believe this schedule should be prepared by the					23
24		client and would have a staff auditor prepare this listing only					24
25		as a last resort. However, some auditors, depending on their					25
26		study and evaluation of internal accounting control, may believe					26
27		this type of schedule need not be included in their working papers.					27
28	(B)	This schedule should include indication of where the detail was					28
29		obtained, for example, "per voucher register." In some instan-					29
30		ces, it may be a carbon or photocopy of the client's own year end					30
31		tabulation of trade payables.					31
32	(C)	This type of schedule may include all trade payables as of the					32
33		balance sheet date or only those over a given amount selected by					33
34		the auditor.					34
35	(D)	A symbol and explanation may be used to identify amounts sub-					35
36		jected to examination of supporting evidence and/or confirmation					36
37		procedures (See section 5400.280 in the chapter on audit objec-					37
38		tives and programs regarding confirmation of accounts payable).					38
39							39
40							40

.511

## Trade Accounts Payable - Schedule

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Source:			Vendor		Balance	Remarks	
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								



.520

ABC Company  
Unrecorded Liabilities Test  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Check No You No or Other Ref	Vendor	Date Received	Description				Account code charged
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21	<b>NOTES:</b>							
22	(A) This working paper should indicate the particular period selected							
23	and records examined in the search for unrecorded liabilities,							
24	for example, cash disbursements book and voucher register for							
25	1/2/X6-1/31/X6. The period selected will vary with the circum-							
26	stances, for example, effectiveness of client's internal control,							
27	billing pattern of client's vendors (do they bill quickly or							
28	slowly after delivery of goods or services) and whether other							
29	audit procedures such as confirmation of payables are to be used.							
30	(B) If amounts selected are subject to a minimum amount(s), this							
31	should also be indicated on this working paper, for example,							
32	"selected all items of \$XXX or over," or "selected all items of							
33	\$100 for 1/1-1/10, all items of \$500 and over for 1/11-1/20 and							
34	all items of \$1000 and over from 1/20 to date of audit report."							
35								
36								
37								
38								
39								
40								

(9)			(10)			(11)			(12)			(13)			(14)			(15)			(16)		
Amount affects						Disposition																	
P&L			Bal sheet																				
																							1
																							2
																							3
																							4
																							5
																							6
																							7
																							8
																							9
																							10
																							11
																							12
																							13
																							14
																							15
																							16
																							17
																							18
																							19
																							20
																							21
																							22
																							23
																							24
																							25
																							26
																							27
																							28
																							29
																							30
																							31
																							32
																							33
																							34
																							35
																							36
																							37
																							38
																							39
																							40

.521

## Unrecorded Liabilities Test

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Check No You No or Other Ref	Vendor	Date Received	Description				Account code charged
1							
2							
3							
4							
5							
6							
7							
8							
9							
10							
11							
12							
13							
14							
15							
16							
17							
18							
19							
20							
21							
22							
23							
24							
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

**AAM § 6500.521**

.530

ABC Company

Accounts Payable - Confirmation Differences  
12/31/X3

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	W.P. Ref	Vendor				Balance per Books	Confirm	Confirm over (under) books
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

(9)				(10)				(11)				(12)				(13)				(14)				(15)				(16)			
← Analysis of				confirm difference				→												Remarks											
Unrecor-				Payment				Shipment				Discount				Other															
ded Liab				in tran-				in tran-				taken																			
				sit				sit																							
																															1
																															2
																															3
																															4
																															5
																															6
																															7
																															8
																															9
																															10
																															11
																															12
																															13
																															14
																															15
																															16
																															17
																															18
																															19
																															20
																															21
																															22
																															23
																															24
																															25
																															26
																															27
																															28
																															29
																															30
																															31
																															32
																															33
																															34
																															35
																															36
																															37
																															38
																															39
																															40

.531

## Accounts Payable - Confirmation Differences

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	W.P. Ref	Vendor				Balance per Books	Confirm over (under) books	
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

**AAM § 6500.531**



.532

ABC Co.

Accounts Payable - Analytical Procedures

Date	Prepared By	Work Paper No.
	Reviewed By	

12/31/X5				Balance	Balance		
G/L A/C				12/31/X4	12/31/X5	Difference	W/P Ref Follow
No.							Up Of Material
							Differences
1							
2			Trade Accounts				
3			Payable				
4			Purchases				
5							
6							
7			Ratio Analysis:				
8							
9			Accounts Payable Turnover:				
10			(Cost of Sales - Beginning Inventory)				
11			+ Ending Inventory				
12			Average Accounts Payable				
13							
14			A/P - Days Outstanding:				
15			365				
16			Accounts Payable Turnover				
17							
18							
19							
20							
21							
22							
23							
24							
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

.533

Date	Prepared By	Work Paper No.
	Reviewed By	

## Accounts Payable - Analytical Procedures

		Balance		Balance		Difference		W/P Ref Follow Up Of Material Differences	
G/L A/C									
No.									
1		Trade Accounts Payable							
2		Payable							
3		Purchases							
4									
5									
6									
7		Ratio Analysis:							
8									
9		Accounts Payable Turnover:							
10		(Cost of Sales - Beginning Inventory)							
11		+ Ending Inventory							
12		Average Accounts Payable							
13									
14		A/P - Days Outstanding:							
15		365							
16		Accounts Payable Turnover							
17									
18									
19									
20									
21									
22									
23									
24									
25									
26									
27									
28									
29									
30									
31									
32									
33									
34									
35									
36									
37									
38									
39									
40									

## ABC Company

.540

## Miscellaneous Current Liabilities

12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)		(2)		(3)		(4)		(5)		(6)		(7)		(8)	
Acct. No.						Balance									
		Description		12/31/X4		12/31/X5		Remarks							
1															1
2															2
3															3
4															4
5															5
6															6
7															7
8															8
9															9
10															10
11															11
12															12
13															13
14															14
15															15
16															16
17															17
18															18
19															19
20															20
21															21
22															22
23															23
24															24
25															25
26															26
27															27
28															28
29															29
30															30
31															31
32															32
33															33
34															34
35															35
36															36
37															37
38															38
39															39
40															40

## NOTE:

Depending on materiality and the assess level of control risk for relevant assertions, the auditor may limit work to review of comparative amounts. Generally, the auditor's concern relates to searching for unrecorded liabilities.

.541

*Miscellaneous Current Liabilities*

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Acct. No.	Description				Balance		
					Remarks		
1							
2							
3							
4							
5							
6							
7							
8							
9							
10							
11							
12							
13							
14							
15							
16							
17							
18							
19							
20							
21							
22							
23							
24							
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

DEF Company

.550

Dividends Payable  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
						Preferred	Common		
						(A)	(A)		
1			Final bal 12/31/X4						1
2									2
3			Add: Declarations (Describe including						3
4			reference to minutes & applic-						4
5			able number of shares per work-						5
6			ing papers on capital stock) (B)						6
7									7
8			Total declared						8
9									9
10			Less: Payments (Describe including						10
11			testing of payments) (B)						11
12									12
13			Total paid						13
14									14
15			Balance 12/31/X5						15
16									16
17									17
18									18
19									19
20			NOTES:						20
21			(A) This illustration assumes that the client has only						21
22			one class each of preferred and common stock. The						22
23			analysis columns may be expanded if more classes of						23
24			capital stock are present. However, if the timing						24
25			of the dividend declarations and payment dates results						25
26			in no year end liability for unpaid dividends, the						26
27			testing shown on this working paper may appear in an						27
28			analysis of retained earnings, and this paper would						28
29			be unnecessary.						29
30			(B) If the auditor prefers, the detail of individual divi-						30
31			dends declared may be presented in an analysis of re-						31
32			tained earnings with a cross reference of unpaid						32
33			dividends to a recap or lead sheet concerning other						33
34			payables.						34
35									35
36									36
37									37
38									38
39									39
40									40

.551

## Dividends Payable

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
						Preferred	Common	
1		Final bal						
2								
3		Add: Declarations (Describe including						
4		reference to minutes & applic-						
5		able number of shares per work-						
6		ing papers on capital stock)						
7								
8		Total declared						
9								
10		Less: Payments (Describe including						
11		testing of payments)						
12								
13		Total paid						
14								
15		Balance						
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

ABC Company  
 .560 Liability for Payroll Taxes Withheld  
 12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Client's Acct	Description	Final Bal 12/31/X4	Bal per client 12/31/X5	AJEs Incr. (Debr.)	Bal as adjusted 12/31/X5		
1							1
2							2
3	Federal income tax						3
4							4
5	FICA						5
6							6
7	State income tax						7
8							8
9	Other (describe)						9
10							10
11							11
12							12
13							13
14							14
15							15
16							16
17							17
18							18
19							19
20							20
21							21
22	NOTE:						22
23							23
24							24
25							25
26							26
27							27
28							28
29							29
30							30
31							31
32							32
33							33
34							34
35							35
36							36
37							37
38							38
39							39
40							40

Depending on the auditor's assessment of control risk, these balances may be tested by reference to subsequent payments and related payroll tax returns, and by analytical review procedures.

.561

## Liability for Payroll Taxes Withheld

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Client's Acct	Description		Final Bal	Bal per client 12/31/X5	AJEs Incr. (Decr.)	Bal as adjusted 12/31/X5	
1								
2								
3			Federal income tax					
4								
5			FICA					
6								
7			State income tax					
8								
9			Other (describe)					
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								



## ABC Company

.570

Accrued Payroll Taxes  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Client's Acct Code	Description		Final Bal 12/31/X4	Bal client 12/31/X5	AJE's Increase (Decrease)	Bal as adjusted 12/31/X5	
1							1
2							2
3							3
4							4
5							5
6							6
7							7
8							8
9							9
10							10
11							11
12							12
13							13
14							14
15							15
16							16
17							17
18							18
19							19
20							20
21							21
22							22
23							23
24							24
25							25
26							26
27							27
28							28
29							29
30							30
31							31
32							32
33							33
34							34
35							35
36							36
37							37
38							38
39							39
40							40

**NOTE:**

Depending on the auditor's assessment of control risk for the relevant assertion, these balances may be tested by reference to subsequent payments and related payroll tax returns, and by analytical review procedures.

.571

## Accrued Payroll Taxes

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Client's Acct Code	Description	Final Bal	Bal client	AJE's Increase Decrease	Bal as adjusted		
1							
2	FICA - employer's						
3	share						
4							
5	FUI						
6							
7	SUI						
8							
9	Other						
10							
11							
12							
13							
14							
15							
16							
17							
18							
19							
20							
21							
22							
23							
24							
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

ABC Company

.580

Accrued Payroll

12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
							Components of Accrual (A)	
1	TEST							1
2	Total payroll week ended Fri 12/28, paid 1/3				100%	xxxxx		2
3								3
4								4
5	Total payroll week ended Fri 1/4 paid 1/9				xxxxx			5
6		12/19-12/31		2 days	33%	xxxxx		6
7		1/1-1/4		4 days	67%			7
8								8
9		[12/30=Sunday - Sundays paid separately if worked per Union Contract & company pol]						9
10								10
11				Amount per test		xxxxx		11
12								12
13				Amount per client		xxxxx	(B)	13
14								14
15								15
16				Difference			(B)	16
17								17
18								18
19								19
20								20
21	NOTES:							21
22								22
23	(A)	Depending on circumstances, the auditor may find it practical to expand this column to an analysis by components, for example, production wages, office salaries and officers salaries.						23
24								24
25								25
26	(B)	The auditor may also wish to note on this working paper the ac- crual as of the prior year end and comment on fluctuation if significant.						26
27								27
28								28
29								29
30								30
31								31
32								32
33								33
34								34
35								35
36								36
37								37
38								38
39								39
40								40

.581

## Accrued Payroll

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
							Components of Accrual	
1	<u>TEST</u>							
2	Total payroll week ended , paid							
3								
4								
5	Total payroll week ended paid							
6								
7								
8								
9								
10								
11								
12	Amount per test							
13								
14	Amount per client							
15								
16	Difference							
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

.590

ABC Company  
 Accruals - Other  
 12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Client's	Title or description	W.P. Ref	12/31/X4 Final	12/31/X5 Per Client	AJEs Incr(Decr)	Bal as adjusted	
1							1
2							2
3	Property taxes	(A)					3
4							4
5	Other, describe	(B)					5
6							6
7							7
8							8
9							9
10							10
11							11
12							12
13							13
14							14
15							15
16							16
17							17
18							18
19							19
20							20
21	<b>NOTES:</b>						
22	(A) Accrued property taxes should be cross-referenced to the working						
23	paper on property taxes prepaid accrued and expensed. See						
24	section 6500.430.						
25	(B) The auditor may evaluate the significance or relative immaterial-						
26	ity of other accruals and then decide whether to limit work to						
27	inquiry of the client and analytical review, or to perform addi-						
28	tional tests.						
29							29
30							30
31							31
32							32
33							33
34							34
35							35
36							36
37							37
38							38
39							39
40							40

.591

Accruals - Other

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Client's	Title or description	W.P. Ref	Final	Per Client	AJEs Incr/Decr	Bal as adjusted	
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

.600

ABC Company  
Debt - Notes Payable & Related Interest (A)  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	← Orig. date	Description (B) Type of debt & maturity	Face Amt	Interest rate	← Principal (C) Bal 12/31/X4	Additions	Payments	
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15	NOTES:							
16	(A) This analysis illustrates how the activity and balances of							
17	principal and related interest can be presented on the same							
18	working paper. This approach may result in more effective work-							
19	ing paper presentation of the analysis and testing performed							
20	and expedite review. It may be practical to prepare separate							
21	analyses for each broad category of debt such as notes payable,							
22	collateralized long term debt, debenture bonds, capitalized							
23	leases, etc.							
24	(B) The description should include the type of debt, face amount,							
25	stated interest rate, payment terms, maturity date, collateral,							
26	if any, and original discount or premium, if any. If the descrip-							
27	tion requires too much space, some of it may be continued on at-							
28	(C) In some instances, long term debt may be administered by a trust							
29	company or institutional lender and be combined with a restric-							
30	tive indenture and a predetermined payment schedule for principal							
31	and interest. In such instances, a copy of the payment schedule							
32	and indenture may serve as carryforward (or permanent file) work-							
33	ing papers, and the principal columns on this schedule restricted							
34	to the year end balance which would be positively confirmed.							
35	The columns for interest and discount or premium and the descrip-							
36	tion would be retained.							
37								
38								
39								
40								

(9)			(10)			(11)			(12)			(13)			(14)			(15)			(16)		
Bal →			Current Portion			← Final Bal 12/31/X4			Interest			Interest			← Bal 12/31/X5 →								
12/31/X5			12/31/X5			Accr Int			Prem(Disc)			Expense			paid			Accr Int			Prem(Disc)		
																							1
																							2
																							3
																							4
																							5
																							6
																							7
																							8
																							9
																							10
																							11
																							12
																							13
																							14
																							15
																							16
																							17
																							18
																							19
																							20
																							21
																							22
																							23
																							24
																							25
																							26
																							27
																							28
																							29
																							30
																							31
																							32
																							33
																							34
																							35
																							36
																							37
																							38
																							39
																							40

## NOTES (continued)

(D) Depending on the circumstances, the following additional information may be needed:

- Amount authorized by the indenture
- Amount issued and not retired or cancelled
- Amounts held by the client
- Amounts held in sinking funds
- Amounts held by affiliates (consolidated and/or unconsolidated)



.601

Debt - Notes Payable & Related Interest

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
← Orig. date	Description Type of debt & maturity	Face Amt	Interest rate	← Bal	Principal Additions	Payments	
1							
2							
3							
4							
5							
6							
7							
8							
9							
10							
11							
12							
13							
14							
15							
16							
17							
18							
19							
20							
21							
22							
23							
24							
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

**AAM § 6500.601**

XYZ Company

.610

Debt - Summary of Assets Pledged  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Description of Asset	Creditor & description			Liability Bal 12/31/X5	Book val of asset 12/31/X5		
1 Accounts receivable	2	3 NOP Factors	4	5 xxxxx	6 xx xxx	7	8
3		3/15/X5 Financing agreement					
4							
5							
6 Inventory-finished goods	7	8 NOP Factors	9	10 xxxxx	11 xx xxx	12	13
7		4/15/X5 Financing agreement					
8							
9							
10							
11 Property, plant-equip	12	13 LMN Mfg Corp	14	15 xxxxx	16 xx xxx	17	18
12		2/28/X4 conditional sales					
13		agreement-last payment					
14		due 1/31/X9					
15							
16							
17 Building #3	18	19 PQ Life Insurance Co	20	21 xxxxxx	22 xxxxx	23	24
18		4/1/X2 Mortgage Note					
19		matures 3/31/Y9					
20							
21							
22 Fire Insurance - XYZ Insurance Co	23	24 TUV Brokerage and Finance Corp	25				
23		Note payable					
24		Policy 11/15/X5-11/15/X6		26 xxxx	27 xxxx	28	29
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

.611

## Debt - Summary of Assets Pledged

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Description of Asset			Creditor & description		Liability Bal	Book val of asset	
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

.612

ABC Co.

Notes Payable and Debt - Analytical Procedures  
12/31/X5

Date	Prepared By	Work Paper No.
	Reviewed By	

1		2		3		4		5		6		7	
G/L A/C						Balance		Balance		Difference		W/P Ref Follow	
No.						12/31/X4		12/31/X5				Up Of Material	
												Differences	
1				Notes Payable									
2				Long Term Debt									
3				Interest Expense									
4													
5													
6													
7				Ratio Analysis:									
8													
9				Long Term Debt/Stockholder Equity									
10													
11				Interest Expense/Net Sales									
12													
13				Average Balance:									
14				Long Term Debt									
15				Notes Payable									
16													
17													
18													
19													
20													
21													
22													
23													
24													
25													
26													
27													
28													
29													
30													
31													
32													
33													
34													
35													
36													
37													
38													
39													
40													

.613

## Notes Payable and Debt - Analytical Procedures

Date	Prepared By	Work Paper No.
	Reviewed By	

1		2		3		4		5		6		7	
G/L A/C				Balance		Balance				Difference		W/P Ref Follow	
No.												Up Of Material	
												Differences	
1			Notes Payable										
2			Long Term Debt										
3			Interest Expense										
4													
5													
6													
7			Ratio Analysis:										
8													
9			Long Term Debt/Stockholder Equity										
10													
11			Interest Expense/Net Sales										
12													
13			Average Balance:										
14			Long Term Debt										
15			Notes Payable										
16													
17													
18													
19													
20													
21													
22													
23													
24													
25													
26													
27													
28													
29													
30													
31													
32													
33													
34													
35													
36													
37													
38													
39													
40													

ABC Company  
 .620 Federal (State) Income Taxes-Accrued & Provided (A)  
 12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
						Acct Totals	Current year 19X5	19X4
1	Accrued payable 12/31/X4							
2	(Refundable) 12/31/X4 (C)							
3								
4	Payments and/or recoveries in 19X5							
5								
6								
7	Itemize and describe individual							
8	cash transactions (D)							
9								
10								
11	Provision - current year (E)							
12								
13								
14	Accrued payable 12/31/X5 (F)							
15								
16	Deferred taxes (G)							
17								
18								
19	NOTES:							
20								
21	(A)	This type of analysis may be prepared separately for federal						
22		income taxes and state and local income taxes or depending on						
23		the circumstances, federal and state income taxes may be pre-						
24		sented on a single spread analysis.						
25	(B)	This illustration assumes that several prior years are still						
26		open and provides individual columns as a means for matching cash						
27		transactions with related provisions for each open year.						
28	(C)	A separate line item for refundable taxes is provided to segre-						
29		gate those amounts from taxes payable.						
30	(D)	Details of individual payments including date, description and						
31		amount should be shown separately because of the compliance im-						
32		plications in the timing and amounts of payments.						
33	(E)	Generally, development of the current year's provision involves						
34		enough detail to require a separate working paper cross-referenced						
35		to this type of account analysis.						
36								
37								
38								
39								
40								

(9)			(10)			(11)			(12)			(13)			(14)			(15)			(16)		
Prior			open years (B)																				
19X3			19X2			19X1			19X0														
																							1
																							2
																							3
																							4
																							5
																							6
																							7
																							8
																							9
																							10
																							11
																							12
																							13
																							14
																							15
																							16
																							17
																							18
																							19
																							20
																							21
																							22
																							23
																							24
																							25
																							26
																							27
																							28
																							29
																							30
																							31
																							32
																							33
																							34
																							35
																							36
																							37
																							38
																							39
																							40

**NOTES (continued)**

(F) In some circumstances, the auditor may prepare (or obtain from the client) this type of analysis through a preliminary date and after testing and review with the client, the schedule may be subsequently brought forward to the year and date.

(G) Deferred taxes are included in separate illustrative working papers at paragraphs 640-643.



.621 Federal (State) Income Taxes-Accrued &amp; Provided

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
						Acct Totals	Current year	
1	Accrued payable							
2	(Refundable)							
3								
4	Payments and/or (recoveries) in							
5								
6								
7	Itemize and describe individual							
8	cash transactions							
9								
10								
11	Provision - current year							
12								
13								
14	Accrued payable							
15								
16	Deferred taxes							
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

**AAM § 6500.621**

.630

ABC Company  
 Provision for Federal (State) Income Taxes  
 12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1	Income before federal and state income taxes, per books							
2								
3								
4	Add and/or (Deduct) interperiod timing differences							
5								
6	(Describe individually and cross reference							
7	to working papers that provide sources of							
8	data and further determination of deferred							
9	tax provisions and related balance sheet							
10	classifications.)							
11								
12								
13	Add and/or (Deduct) permanent differences							
14								
15	(Describe specifically and cross reference							
16	to source working papers. For some							
17	situations such as tax exempt municipal							
18	bond interest, state and local income tax							
19	requirements may differ from those for							
20	federal income taxes.)							
21								
22								
23	Estimated taxable income - state-local							
24								
25	Less: provisions for state-local income taxes							
26								
27	Estimated taxable income - federal							
28								
29	Tax computations							
30								
31								
32								
33								
34	Estimated tax provision							
35								
36								
37								
38								
39								
40								

(9)			(10)			(11)			(12)			(13)			(14)			(15)			(16)		
Federal income tax									State income tax														
For cur- rent ret.			Timing differences						For cur- rent ret.			Timing differences											
Amt			Tax effect						Amt			Tax effect											
																						1	
																						2	
																						3	
																						4	
																						5	
																						6	
																						7	
																						8	
																						9	
																						10	
																						11	
																						12	
																						13	
																						14	
																						15	
																						16	
																						17	
																						18	
																						19	
																						20	
																						21	
																						22	
																						23	
																						24	
																						25	
																						26	
																						27	
																						28	
																						29	
																						30	
																						31	
																						32	
																						33	
																						34	
																						35	
																						36	
																						37	
																						38	
																						39	
																						40	

.631

## Provision for Federal (State) Income Taxes

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

Income before federal and state income taxes, per books

Add and/or (Deduct) interperiod timing differences

Add and/or (Deduct) permanent differences

Estimated taxable income - state-local

Less: provisions for state-local income taxes

Estimated taxable income - federal

Tax computations

Estimated tax provision

**AAM § 6500.631**

.640

ABC Company

## Deferred Income Taxes &amp; Temporary Differences (A)

Date	Prepared By	Work Paper No.
	Reviewed By	

12/31/X5		1	2	3	4
		Book Basis	Tax Basis	Temporary Difference	Future 19X6
<b>ASSETS:</b>					
1	Cash	25000	25000	-0-	
2	Inventory	600000	650000	<50000>	<50000>
3	P.P. & E (Net)	800000	400000	400000	<65000>
4		1425000	1075000		
<b>LIABILITIES:</b>					
7	Accounts Payable	120000	120000	-0-	
8	Warranty Obligation	300000	-0-	<300000>	<45000>
9		210000	120000		
10	Taxable <Deductible> Amounts			50000	<160000>
12	Carryforward of Net Deductible Amounts				160000
13	Carryback of Net Deductible Amounts				
14	Net Taxable <Deductible> Amounts				-0-
15				<b>Total</b>	
16	Currently Enacted Tax Rates: (B)				
17	15% of First 50000			7500	-0-
18	25% of Next 25000				
19	34% of Amount Over 75000				
20				7500	-0-
21	Deferred Tax Balances - 12/31/X5				
22	Current Portion - 19X6			-0-	
23	Non Current Portion			7500	
26	<b>Journal Entry:</b>			<b>Adjustment</b>	
27		12/31/X5	12/31/X4	<DR> CR	
28	Current Portion	-0-	<1000>	1000	
29	Non Current Portion	7500	7700	<200>	
30		7500	6700	800	
31	Income Statement (Select Accounts) (Book Income - 300,000)				
32		19X5	(Taxable Income - 350,000)		
33	Pretax Income	300000			
34					
35	Income Tax Expense				
36	Current	107250			
37	Deferred	800			
38		108050			
39	Net Income	191950			
40	Effective Tax Rate	36%			

5			6			7			8			9			10		
Years			Reversals - Taxable			<Deductible>											
19x7			19x8			19x9											
																	1
																	2
		185000			205000			75000									3
																	4
																	5
																	6
																	7
		<65000>			<85000>			<105000>									8
																	9
		120000			120000			<30000>									10
																	11
		<120000>			<40000>												12
					<30000>			30000									13
		-0-			50000			-0-									14
																	15
		-0-			7500			-0-									16
																	17
																	18
		-0-			7500			-0-									19
																	20
																	21
																	22
																	23
																	24
																	25
																	26
																	27
																	28
																	29
																	30
																	31
																	32
																	33
																	34
																	35
																	36
																	37
																	38
																	39
																	40

**Notes:**

- (A) This schedule assumes there are no net operating losses in the current or prior years. Calculation of deferred tax assets is illustrated in section 6500.642.
- (B) "Shortcut" techniques such as applying an average tax rate or the company's highest tax rate to net taxable amounts are permitted by FASB Statement No. 96 provided the results do not materially differ from those obtained by strict application of graduated tax rates.
- (C) This illustration addresses only federal deferred income taxes. Separate schedules of temporary differences and deferred income taxes for each taxing jurisdiction should be prepared.



### Deferred Income Taxes & Temporary Differences

Date	Prepared By	Work Paper No.
	Reviewed By	

Copyright © 1988, American Institute of Certified Public Accountants, Inc.

5	6	7	8	9	10
Years	Reversals - Taxable				
	<Deductible>				
					1
					2
					3
					4
					5
					6
					7
					8
					9
					10
					11
					12
					13
					14
					15
					16
					17
					18
					19
					20
					21
					22
					23
					24
					25
					26
					27
					28
					29
					30
					31
					32
					33
					34
					35
					36
					37
					38
					39
					40

ABC Co.

Date	Prepared By	Work Paper No.
	Reviewed By	

**.642** Deferred Income Taxes & Temporary Differences (A)  
12/31/X5

		Temporary Differences		Future Years Reversals --		Taxable <Deductibles>	
		19X5	19X6	19X7	19X8	19X9	
1	Inventory	<50000>	<50000>				
2	PP & E (Net)	400000	<65000>	185000	205000	75000	
3	Warranty Obligation	<300000>	<45000>	<65000>	<85000>	<105000>	
4	Taxable <Deductible> Amounts	50000	160000	120000	120000	30000	
5							
6	<b>CASE I</b> - Carrybacks to taxes paid in 19X4 are available for \$120000 of 19X6's net						
7	deductible amount. No taxes to be paid in 19X5.						
8							
9	Carryback to 19X4		120000				
10	Carryforward to 19X7		40000	<40000>			
11	Carryback to 19X7			<30000>		30000	
12	Net Taxable Deductible Amounts		-0-	50000	120000	-0-	
13							
14	Deferred Tax Asset - Current (120000 Carried Back @ 46%)				55200		
15	Deferred Tax Liability - Non Current (50000 @ 34%)						
16			(120000 @ 34%)		57800		
17							
18	<b>CASE II</b> - Loss Carryforward only (no taxable income in prior years to which deductible						
19	amounts may be carried back)						
20	Totals, As Above		<160000>	120000	120000	<30000>	
21	Carryforward		160000	<120000>	<40000>		
22	Carryback to 19X8				<30000>	30000	
23			-0-	-0-	50000	-0-	
24							
25	Deferred Tax Liability - Non Current (50000 @ 34%)				17000		
26							
27							
28	<b>NOTES:</b>						
29	(A) These examples illustrate the effects of carrybacks and carryforwards of net						
30	operating losses and net deductible amounts on the computation of deferred income						
31	taxes under various circumstances.						
32	<b>ASSUMPTIONS:</b>						
33	(1) Additional originating difference of \$65000 in depreciation arises in 19X6.						
34	(2) Tax rates: 19X4 - 46%, 19X5 - 40%, 19X6 and later - 34%						
35	(3) No material difference arises between application of graduated rates versus						
36	maximum rates						
37							
38	(CONTINUED)						
39							
40							

ABC Co.

.642

Deferred Income Taxes &amp; Temporary Differences

12/31/X5

Date	Prepared By	Work Paper No.
	Reviewed By	

	1	2	3	4	5	6	7
				19X6	19X7	19X8	19X9
1	CASE III - Loss carryforward only, and NOL carryforward of \$20000 from 19X4						
2							
3	Totals, As Above			<160000>	120000	120000	<30000>
4	NOL Carryforward				<20000>		
5	Carryforward			160000	<100000>	<60000>	
6	Carryback					<30000>	30000
7				-0-	-0-	30000	-0-
8							
9							
10	Deferred Tax Liability - Non Current (30000 @ 34%)					10200	
11							
12							
13							
14							
15	CASE IV - Operating Loss of \$190000 in 19X5, of which \$100000 may be carried back to 19X4.						
16							
17	Totals, As Above			<160000>	120000	120000	<30000>
18	NOL - 19X7				<90000>		
19	Carryforward to 19X8 and X9			150000	<30000>	<120000>	
20				<10000>	-0-	-0-	<30000>
21							
22	Refundable Income Taxes (100000 @ 46%)					46000	
23							
24	Unrecognizable Net Deductible Amounts					40000	
25	(Unrecognizable because there are no periods						
26	to which the amounts may be carried back or						
27	forward.)						
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

[The next page is 6709.]



.643

## Deferred Income Taxes &amp; Temporary Differences

Date	Prepared By	Work Paper No.
	Reviewed By	

	1	2	3	4	5	6	7
			Temporary Differences	Future Years Reversals --		Taxable <Deductibles>	
1							
2							
3							
4							
5							
6							
7							
8							
9							
10							
11							
12							
13							
14							
15							
16							
17							
18							
19							
20							
21							
22							
23							
24							
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

ABC Company  
.650 Contingent Liabilities and Commitments Other Than Leases  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
W.P. Ref.	Classification and Description (A)				Amount	Disposition (C)	
1							1
2							2
3							3
4							4
5							5
6							6
7							7
8							8
9							9
10							10
11							11
12							12
13							13
14							14
15							15
16							16
17							17
18							18
19							19
20							20
21							21
22							22
23							23
24							24
25							25
26							26
27							27
28							28
29							29
30							30
31							31
32							32
33							33
34							34
35							35
36							36
37							37
38							38
39							39
40							40

NOTES:

(A) See SAS No. 12, paragraphs 5-7 on audit procedures regarding litigation, claims and assessments. Also see SAS No. 19 on Client Representations.

(B) Working paper references may include those on review of minutes, standard bank confirmations, review of agreements and contracts, review of legal fees, inquiries of management and lawyers' letters.

(C) Disposition column may include reference to footnote disclosure, inclusion in the client representation, and, if necessary, the item's effect on the auditor's report.

ABC Company

## .651 Contingent Liabilities and Commitments Other Than Leases

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
W. P. Ref.	Classification and Description				Amount	Disposition	
1							
2							
3							
4							
5							
6							
7							
8							
9							
10							
11							
12							
13							
14							
15							
16							
17							
18							
19							
20							
21							
22							
23							
24							
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							



ABC Company  
 .660 Capital Stock & Additional Pd in Capital-Analysis  
 12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)		(2)		(3)		(4)		(5)		(6)		(7)		(8)	
						Capital stock, par val X per share		Auth No. of shares XXXXX				Additional paid in			
						No. of		Amount		No. of shs		Cost of		in	
						shares				held in		treas.		capital	
						issued				treasury		stock			
1															1
2															2
3															3
4															4
5															5
6															6
7															7
8															8
9															9
10															10
11															11
12															12
13															13
14															14
15															15
16															16
17															17
18															18
19															19
20															20
21															21
22															22
23															23
24															24
25															25
26															26
27															27
28															28
29															29
30															30
31															31
32															32
33															33
34															34
35															35
36															36
37															37
38															38
39															39
40															40

## NOTES:

It may be helpful to prepare this type of analysis as a carryforward working paper.

If several classes of capital stock are present, the analysis can be prepared on wider columnar paper to use the additional columns for the various classes of stock.

## .661 Capital Stock &amp; Additional Pd in Capital-Analysis

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
				Capital stock, par val per share		Additional		
				Auth No. of shares		paid		
				No. of		No. of shs	Cost of	in
				shares	Amount	held in	treas.	capital
				issued		treasury	stock	
1								
2								
3								
4	Balance							
5								
6								
7								
8								
9								
10								
11								
12								
13	Balance							
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

ABC Company  
 .670 Capital Stock - Certificate Book Examination  
 (Carry Forward)

Initials	Date
Prepared By	
Approved By	

(1)		(2)		(3)	(4)	(5)	(6)	(7)	(8)
Exam Done by Date		Unissued Ctf Nos. From-To		Name to whom issued			Certificate Issued		
							Ctf No.	Date issued	No. of shares
1				Albert Able			1	3/15/X0	500
2				Bartholomew Baker			2	3/15/X0	500
3	WCF 1/15/X1	3	- 100	Re 12/31/X0					
4				Carlton P. Charlie			3	4/1/X1	250
5	WCF 1/5/X2	4	- 100	Re 12/31/X1					
6				Carlton P. Charlie			4	12/30/X2	250
7	JD 1/10/X3	5	- 100	Re 12/31/X2					
8	RR 1/12/X4	5	- 100	Re 12/31/X3					
9	RR 1/3/X5	5	- 100	Re 12/31/X4					
10				Francine P. Able			5	5/30/X5	100
11				Albert Able			6	5/30/X5	400
12				Godfrey Delta			7	9/2/X5	100
13				Mary Baker			8	10/31/X5	100
14				Bartholomew Baker			9	10/31/X5	400
15	ES 1/2/X6	10	- 100	Re 12/31/X5					
16	ES 1/2/X7	10	- 100	Re 12/31/X6					
17									
18									
19									
20									
21									
22									
23									
24									
25									
26									
27									
28									
29									
30									
31									
32									
33									
34									
35									
36									
37									
38									
39									
40									

(9)		(10)	(11)		(12)		(13)	(14)	(15)	(16)	
Ctfs retired or transferred			Number of shares outstanding, per ctf. book								
Date ret or trfd	No. of shares	Ctf no. of new shares	12/31/X0	12/31/X1	12/31/X2, X3, X4	12/31/X5, X6					
5/30/X5	500	5 & 6	500	500	500						
10/31/X5	500	8 & 9	500	500	500						
			<u>1000</u>								
				<u>250</u>	250	250					
				<u>1250</u>							
					250	250					
					<u>1500</u>						
					<u>1500</u>						
					<u>1500</u>						
						100					
						400					
						100					
						100					
						400					
						<u>1600</u>					
						<u>1600</u>					

.671 Capital Stock - Certificate Book Examination  
(Carry Forward)

Initials	Date
Prepared By	
Approved By	

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Exam			Unissued		Certificate Issued		
	Done	Ctf Nos.	Name to whom issued			Ctf	Date	No. of
	by	From-To				No.	issued	shares
	Date							
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

**AAM § 6500.671**

.680

ABC Company  
Retained Earnings - Analysis  
(Carryforward)

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
			19X0	19X1	19X2	19X3	19X4	19X5	
1									1
2	Balance, beginning								2
3	of year								3
4									4
5	Net income for year								5
6									6
7	Dividends declared								7
8	and paid:								8
9	(Describe) (A)								9
10									10
11									11
12									12
13									13
14									14
15									15
16									16
17									17
18									18
19									19
20									20
21									21
22									22
23									23
24									24
25	Balance, end of year								25
26									26
27									27
28									28
29									29
30									30
31									31
32									32
33									33
34	NOTE:								34
35									35
36	(A) If more than one class of stock is present, segregate dividends								36
37	into groups according to each class of stock.								37
38									38
39									39
40									40

.681

*Retained Earnings - Analysis*  
*(Carryforward)*

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								



## Revenue and Expense Working Papers—General Note

.690 Working papers on revenue and expense accounts would include comparative lead sheets for each income statement classification. Expenses such as depreciation, insurance, interest, and the provision for doubtful accounts would be cross-referenced to related analyses included among working papers concerning the balance sheet classifications.

The auditor, after considering his evaluation of the internal control structure, may decide that analytical procedures (see SAS No. 56 [AU section 329]) and substantive tests of balance sheet accounts (including related income and expense effects) provide enough evidence to avoid the need for detailed analysis of most individual revenue and expense accounts. Some revenue and expense accounts, however, are ordinarily analyzed and tested because of the following:

- Identification of possible disclosure matters (especially lawyers' billings).
- Information needed for preparation of tax returns and other reports.
- Generalized titles that make accounts subject to misclassifications and errors.

Accounts requiring separate analyses generally are:

Legal expenses and other professional fees

Maintenance and repairs

Travel and entertainment

Officers' salaries and expenses

Taxes, licenses, and fees

Rents and royalties

Contributions

Advertising

For timesaving purposes, the auditor may request the client to prepare analyses of these accounts and to assemble the related vouchers and other supporting documents.

.700

ABC Company  
 Legal Expense  
 12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)			(2)			(3)			(4)			(5)			(6)			(7)			(8)		
Name of lawyer or law firm									Description of matter (A)									Date of billing			Amount		
1																							
2																							
3																							
4																							
5																							
6																							
7																							
8																							
9																							
10																							
11																							
12																							
13																							
14																							
15																							
16																							
17																							
18																							
19																							
20																							
21																							
22																							
23																							
24																							
25																							
26																							
27																							
28																							
29																							
30																							
31	NOTES:																						
32																							
33	(A) Descriptions should be related (referenced) to such other																						
34	working papers as contingencies and commitments and manage-																						
35	ment representations.																						
36	(B) The final amount from the preceding year may be useful for																						
37	comparison purposes. A significant fluctuation should be																						
38	explained.																						
39	(C) A similar working paper format may be used for other profes-																						
40	sional fees.																						

.701

*Legal Expense*

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Name of lawyer or law firm			Description of matter			Date of billing	Amount
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26				Total				
27								
28				Total				
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

.710

ABC Company  
 Maintenance & Repairs Expense  
 12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Date	Check or You. No.	Vendor	Description				Amount
1							1
2							2
3							3
4							4
5							5
6							6
7							7
8							8
9							9
10							10
11							11
12							12
13							13
14							14
15							15
16							16
17							17
18							18
19							19
20							20
21							21
22							22
23							23
24							24
25							25
26							26
27							27
28							28
29							29
30							30
31							31
32							32
33							33
34							34
35							35
36							36
37							37
38							38
39							39
40							40

Subtotal, details requested (A)

All other, each of which is under \$XXX (A)

Total

Memo - final total 12/31/X4 (B)

## NOTES:

(A) The auditor may decide to limit testing to items over a certain dollar amount, based on the client's capitalization policy, rather than all components of the account. If so, the limits should be indicated.

(B) The final amount for the preceding year may be useful for comparison purposes. A significant fluctuation should be explained.

.711

## Maintenance &amp; Repairs Expense

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
Date	Check or Vou. No.	Vendor	Description				Amount
1							
2							
3							
4							
5							
6							
7							
8							
9							
10							
11							
12							
13							
14							
15							
16							
17							
18							
19							
20							
21							
22							
23							
24							
25							
26							
27							
28							
29							
30							
31							
32							
33							
34							
35							
36							
37							
38							
39							
40							

ABC Company

.720

Officers Salaries and Expense  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
	Name of officer and position			Social security no.	Time devoted to business	Percent of corp. stock owned Common Preferred		Amount of compensa.	Expense account allowance
1									1
2									2
3									3
4									4
5									5
6									6
7									7
8									8
9									9
10									10
11									11
12									12
13									13
14									14
15									15
16									16
17									17
18									18
19									19
20									20
21									21
22									22
23									23
24									24
25									25
26									26
27									27
28									28
29									29
30									30
31	* The final amount from the preceding year may be								31
32	useful for comparison purposes. A significant								32
33	fluctuation should be explained.								33
34									34
35									35
36									36
37									37
38									38
39									39
40									40

.721

## Officers Salaries and Expense

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Name of officer and position			Social security no.	Time devoted to business	Percent of corp. stock owned Common Preferred	Amount of compensa.	Expense account allowance
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26				Total				
27								
28				Final amount				
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

.730

ABC Company  
Taxes, Licenses and Fees  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
					19X4	19X5		
1								1
2	State and local income taxes							2
3								3
4	(Relate to balance sheet analysis							4
5	working papers on income taxes							5
6	accrued and provided, or provide							6
7	details)							7
8								8
9	Property taxes							9
10								10
11	(Relate to balance sheet analysis							11
12	working papers on property taxes							12
13	prepaid and accrued, or provide							13
14	details)							14
15								15
16	Payroll taxes							16
17	FICA							17
18	SUI							18
19	FUI							19
20								20
21	(Relate to balance sheet analysis							21
22	working papers on payroll taxes							22
23	accrued, or provide details)							23
24								24
25	Other taxes, licenses and fees							25
26								26
27	(Describe in detail)							27
28								28
29								29
30								30
31	Totals							31
32								32
33								33
34								34
35								35
36								36
37								37
38								38
39								39
40								40



.731

## Taxes, Licenses and Fees

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
1								
2	State and local income taxes							
3								
4								
5								
6								
7								
8								
9	Property taxes							
10								
11								
12								
13								
14								
15								
16	Payroll taxes							
17	FICA							
18	SUI							
19	FUI							
20								
21								
22								
23								
24								
25	Other taxes, licenses and fees							
26								
27								
28								
29								
30								
31	Totals							
32								
33								
34								
35								
36								
37								
38								
39								
40								

.740

ABC Company  
Rents and Royalties (A)  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)	
				19X4 Final as reported (B)	← 19X5 → Per client	AJEs Incr/Dechr	as ad- justed	W.P. Ref	
1									1
2	Rents								2
3									3
4	(Describe and cross-								4
5	reference to working								5
6	papers on the under-								6
7	lying leases.)								7
8									8
9									9
10									10
11									11
12									12
13	Royalties								13
14									14
15	(Describe and cross-								15
16	reference to working								16
17	papers on the under-								17
18	lying royalties.)								18
19									19
20									20
21									21
22									22
23									23
24									24
25	NOTES:								25
26									26
27	(A) Separate schedules may be prepared for rents, and for								27
28	royalties if more practical.								28
29									29
30	(B) If the fluctuation between the current and preceding								30
31	year is significant, it should be explained.								31
32									32
33									33
34									34
35									35
36									36
37									37
38									38
39									39
40									40

.741

*Rents and Royalties*

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
				Final as reported	← Per client	AJEs Incr/Decr	→ as ad- justed	W.P. Ref
1								
2	Rents							
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13	Royalties							
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

.750

ABC Company  
Interest Expense Recap  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
W.P. Ref. (A)	Description (A)		Final 19X4	Per client 19X5	AJEs incr(decr)	as ad- justed 19X5	
1							1
2	Notes payable						2
3							3
4							4
5	Long term debt						5
6							6
7							7
8	Capitalized leases						8
9							9
10							10
11	Other (describe) (B)						11
12							12
13							13
14							14
15							15
16							16
17	Total						17
18							18
19							19
20				(B)			20
21	NOTES:						21
22							22
23	(A) Generally, the significant components of interest expense						23
24	should be totals cross-referenced from applicable balance						24
25	sheet analyses of the underlying debt and its related interest						25
26	accruals and expense.						26
27							27
28	(B) If the difference between amounts for the current and preced-						28
29	ing year are significant, they should be explained.						29
30							30
31							31
32							32
33							33
34							34
35							35
36							36
37							37
38							38
39							39
40							40

.751

## Interest Expense Recap

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	W.P. Ref.	Description		Final	Per client	AJEs incr(decr)	as ad- justed	
1								
2		Notes payable						
3								
4								
5		Long term debt						
6								
7								
8		Capitalized leases						
9								
10								
11		Other						
12								
13								
14								
15								
16								
17		Total						
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

.760

ABC Company  
Other Income  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)			(2)			(3)			(4)			(5)			(6)			(7)			(8)			
	Date			Received			From						Description						Amount						
1																							1		
2																							2		
3																							3		
4																							4		
5																							5		
6																							6		
7																							7		
8																							8		
9																							9		
10																							10		
11																							11		
12																							12		
13																							13		
14																							14		
15																							15		
16																							16		
17																							17		
18																							18		
19																							19		
20																							20		
21																							21		
22																							22		
23																							23		
24																							24		
25																							25		
26																							26		
27																							27		
28																							28		
29																							29		
30																							30		
31																							31		
32																							32		
33																							33		
34																							34		
35																							35		
36																							36		
37																							37		
38																							38		
39																							39		
40																							40		

.761

## Other Income

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Date	Received From			Description			Amount
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

.770

ABC Company  
Other Expense  
12/31/X5

	Initials	Date
Prepared By		
Approved By		

	(1)			(2)			(3)			(4)			(5)			(6)			(7)			(8)			
	Date			Payee			Description												Amount						
1																							1		
2																							2		
3																							3		
4																							4		
5																							5		
6																							6		
7																							7		
8																							8		
9																							9		
10																							10		
11																							11		
12																							12		
13																							13		
14																							14		
15																							15		
16																							16		
17																							17		
18																							18		
19																							19		
20																							20		
21																							21		
22																							22		
23																							23		
24																							24		
25																							25		
26																							26		
27																							27		
28																							28		
29																							29		
30																							30		
31																							31		
32																							32		
33																							33		
34																							34		
35																							35		
36																							36		
37																							37		
38																							38		
39																							39		
40																							40		



.771

## Other Expense

	Initials	Date
Prepared By		
Approved By		

	(1)	(2)	(3)	(4)	(5)	(6)	(7)	(8)
	Date		Payee			Description		Amount
1								
2								
3								
4								
5								
6								
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

ABC Co.

**.772** Expense Accounts - Analytical Procedures

Date	Prepared By	Work Paper No
	Reviewed By	

12/31/X5																	
G/L A/C				Balance		Balance		Difference		W/P Ref Follo		Up Of Material		Differences			
No.				12/31/X4		12/31/X5											
1			Legal Expense														
2			Officers Salaries														
3			Taxes & Licenses														
4			Rents & Royalties														
5			Other Income														
6			Other Expense														
7																	
8																	
9																	
10																	
11																	
12																	
13																	
14																	
15																	
16																	
17																	
18																	
19																	
20																	
21																	
22																	
23																	
24																	
25																	
26																	
27																	
28																	
29																	
30																	
31																	
32																	
33																	
34																	
35																	
36																	
37																	
38																	
39																	
40																	

## .773 Expense Accounts - Analytical Procedures

Date	Prepared By	Work Paper No.
	Reviewed By	

G/L A/C		Balance		Balance		Difference		W/P Ref Follow
No.								Up Of Material
								Differences
1		Legal Expense						
2		Officers Salaries						
3		Taxes & Licenses						
4		Rents & Royalties						
5		Other Income						
6		Other Expense						
7								
8								
9								
10								
11								
12								
13								
14								
15								
16								
17								
18								
19								
20								
21								
22								
23								
24								
25								
26								
27								
28								
29								
30								
31								
32								
33								
34								
35								
36								
37								
38								
39								
40								

## AAM Section 7000

# CORRESPONDENCE, CONFIRMATIONS & REPRESENTATIONS

These samples are presented for illustrative purposes only. They are intended as mere conveniences for users of this Manual who may want points of departure when designing their own formats to meet their individual needs. These illustrations are neither all inclusive nor are they prescribed minimums. Auditors and accountants are to rely on professional standards and their individual professional judgment in determining what may be needed in the circumstances.

## TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
7100	Control of Confirmations and Correspondence . . . . .	.01-.07
7200	Requests for Confirmations and Related Materials . . . . .	.01-.23
	Wording of Confirmation Request Forms . . . . .	.01-.02
	Request for Bank Cutoff Statements . . . . .	.03
	Standard Bank Confirmation Inquiry . . . . .	.04
	Request for Confirmation of Petty Cash Fund and Advances to Employees . . . . .	.05
	Securities and Cash in Custodian or Trust Accounts . . . . .	.06
	Securities Held by Brokers . . . . .	.07
	Sample Receipts for Return of Cash or Securities Counted by Auditor's Representative, and Cutoff Bank Statements Received Directly by the Auditors . . . . .	.08
	Accounts Receivable—Positive . . . . .	.09
	Accounts Receivable—Negative . . . . .	.10
	Notes Receivable . . . . .	.11
	Inventories Held by Warehouses or Others When Listing Is Not Provided by Client . . . . .	.12
	Inventories Held by Warehouses or Others When Listing Is Provided by Client . . . . .	.13
	Standard Confirmation Inquiry for Life Insurance Policies . . . . .	.14
	Pension Plan Actuarial Cost Information . . . . .	.15A
	Pension Plan Actuarial Information . . . . .	.15B
	Pension Plan Assets Held by Trustee . . . . .	.16
	Notes Payable . . . . .	.17
	Mortgage Debt . . . . .	.18
	Accounts Payable . . . . .	.19
	Obligation to Lessor . . . . .	.20
	Property Out on Lease . . . . .	.21
	Registrar—Capital Stock . . . . .	.22
	Transfer Agent—Capital Stock . . . . .	.23
	Request for Confirmation of Money Market Fund . . . . .	.24
7300	Inquiries to Legal Counsel . . . . .	.01-.03
	Illustrative Inquiry Letter to Legal Counsel . . . . .	.01
	Illustrative Inquiry Letter to Legal Counsel If Management Has Not Provided Details About Pending or Threatened Litigation . . . . .	.02
	Improving Inquiry Techniques . . . . .	.03
7400	Representation Letters . . . . .	.01-.03
	Illustrative Representation Letter—Audit of Financial Statements . . . . .	.01

<i>Section</i>	<i>Paragraph</i>
7400 Representation Letters—continued	
Illustrative Representation Letter—Review of Financial Statements . . . . .	.02
Illustrative Representation Letter—Personal Financial Statements . . . . .	.03

---

[The next page is 7101.]

# AAM Section 7100

## *Control of Confirmations and Correspondence*

.01 Generally, clients prepare correspondence and confirmation requests on their own letterheads and submit the signed originals and copies needed to the auditor. The auditor may obtain one or more copies to serve as file copies for the current working papers, second requests and manuscript copies for the next engagement.

.02 The auditor should review the confirmation requests to the extent he considers necessary. For example, the auditor may perform the following for accounts receivable confirmation requests before they are mailed:

- Compare the customer names and addresses to the client's records.
- Compare balances per confirmation requests to the subsidiary ledger.

.03 The requests would then be stuffed in envelopes and submitted to the post office under the auditor's control.

.04 The auditor controls the mailings and receipt of responses so that the confirmation process is independent of the client.

.05 Mailing envelopes have the auditor's office or post office box number as the return address so that undeliverable letters are returned to the auditor and not to the client. For mailings, the auditor may provide the envelopes or affix a label on the client's envelope that covers the client's return address and replaces it with the auditor's address.

.06 Reply envelopes addressed to the auditor are enclosed with the request letter. Reply envelopes generally have prepaid postage to encourage responses. Some auditors also use codes on the reply envelopes so that responses may be sorted by engagement before the mail is opened. This feature may be particularly useful when there are several engagements that involve voluminous mailings.

.07 If the client objects to use of the auditor's name and address, some auditors suggest that a post office box in the client's name be used, with the returns to be opened under the auditor's control for the confirmation process, and that the post office be instructed that after the box is closed subsequent mail be forwarded to the auditor.

---

[The next page is 7201.]



# **AAM Section 7200**

## ***Requests for Confirmations and Related Materials***

### **Wording of Confirmation Request Forms**

.01 Forms and correspondence used for confirmation requests should state clearly that the client is requesting that a reply be sent to the CPA. Forms and correspondence used for information requests for engagements other than audits should not refer to "an audit." They should also use the term "accountant(s)" rather than "auditors." Suggested wording follows:

Please send the following information to our professional accountants (insert name and address of accountants) who are performing services for the company.

.02 The samples of correspondence in this section include language that refers to auditors and an audit of the client's financial statements on the assumption that an audit is being performed. This language needs to be modified if services other than an audit are being performed.



**.03 Request for Bank Cutoff Statements**

(Prepared on client's letterhead)

(Date) [Note (A) below]

(Name of Bank)

(Address)

Dear.....:

Please send the following information directly to our auditors (insert name and address of auditors) who are performing their regular audit of our financial statements [Note (B) below] as of the close of business (insert date):

1. The information requested on the enclosed standard bank confirmation inquiry form(s)
2. Statement(s) of our account(s) and the related paid checks for the period from (insert date) to (insert date) inclusive. (Give name and bank account number for each bank account)
3. [Note (C)]

Very truly yours,

(Name of client)

(Signature and title of authorized officer)

---

NOTES TO USER:

- (A) The request should be sent at least ten days prior to the audit date so the bank will be able to provide the information requested and to render the cutoff statements as requested. If the request does not reach the bank before the cutoff date, the cutoff statement will include transactions recorded after that date.
- (B) It is helpful to include a list of the account names and bank account numbers for each of the clients' accounts to receive timely and complete response.
- (C) The letter may also include requests for:
- A statement of all securities or other items held for the client's account as of the closing date for collection or safekeeping, or as agent or trustee (including titles and bank account numbers).
  - List of authorized check signers for the above accounts. (This may have been previously requested at a preliminary date in connection with the assessment of control risk.)

.04

## STANDARD BANK CONFIRMATION INQUIRY\*

RETURN  
TO:

Date:

Your completion of the following report will be sincerely appreciated. IF THE ANSWER TO ANY ITEM IS "NONE," PLEASE SO STATE. Use the enclosed envelope to return the original directly to our accountant (see name to left).

REPORT  
FROM  
BANK

Yours truly,

(ACCOUNT NAME: PER BANK RECORDS)

By \_\_\_\_\_  
Authorized Signature
☐ Bank customer should check here if confirmation of bank balances only (Item ①) is desired.

NOTE—If the space provided is inadequate, please enter totals hereon and attach a statement giving full details called for by the columnar headings below.

- ① At the close of business on \_\_\_\_\_ 19\_\_\_\_ our records showed the following balance(s) to the credit of the above named customer. In the event that we could readily ascertain whether there were any balances to the credit of the customer not designated in this request, the appropriate information is given below.

designated in this request, the appropriate information is given below.

			SUBJECT TO WITHDRAWAL BY CHECK?		
AMOUNT	ACCOUNT NAME	ACCOUNT NO.	✓	INTEREST BEARING? GIVE RATE.	REMARKS
\$					
(Some banks request that they be provided with account name and number)					

- ② The customer was directly liable to us in respect of loans, acceptances, etc., at the close of business on that date in the total amount of \$ \_\_\_\_\_, as follows:

AMOUNT	DATE		INTEREST		DESCRIPTION OF LIABILITY, COLLATERAL, SECURITY INTERESTS, LIENS, ENDORSERS, ETC.
	OF LOAN/DISCOUNT	DUE	RATE	PAID TO	
\$					

- ③ The customer was contingently liable as endorser of notes discounted and/or as guarantor at the close of business on that date in the total amount of \$ \_\_\_\_\_, as below:

AMOUNT	NAME OF MAKER	DATE		REMARKS
		OF NOTE	DUE	
\$				

- ④ Other direct or contingent liabilities, open letters of credit, and relative collateral, were:

- ⑤ Security agreements under the Uniform Commercial Code or any other agreements providing for restrictions, not noted above, were as follows (if officially recorded, indicate date and office in which filed):

• Approved 1966 by American Institute of Certified Public Accountants and Bank Administration Institute (formerly NABAC)  
Additional forms available from:  
AICPA—ORDER  
P.O. BOX 0946, NYC NY 10108-0946

Date:

Yours truly, (Bank)

By \_\_\_\_\_  
Authorized Signature — Bank

ORIGINAL  
To be mailed to accountant

## STANDARD BANK CONFIRMATION INQUIRY\*

RETURN  
TO:

Date:

Your completion of the following report will be sincerely appreciated. IF THE ANSWER TO ANY ITEM IS "NONE," PLEASE SO STATE. Use the enclosed envelope to return the original directly to our accountant (see name to left).

REPORT  
FROM  
BANK

Yours truly,

(ACCOUNT NAME PER BANK RECORDS)

By \_\_\_\_\_  
Authorized Signature
☐ Bank customer should check here if confirmation of bank balances only (Item 1) is desired.

NOTE—If the space provided is inadequate, please enter totals hereon and attach a statement giving full details called for by the columnar headings below.

- ① At the close of business on \_\_\_\_\_ 19\_\_\_\_ our records showed the following balance(s) to the credit of the above named customer. In the event that we could readily ascertain whether there were any balances to the credit of the customer not designated in this request, the appropriate information is given below.

designated in this request, the appropriate information is given below.			SUBJECT TO WITHDRAWAL BY CHECK?		
AMOUNT	ACCOUNT NAME	ACCOUNT NO.	✓ INTEREST BEARING? GIVE RATE.	REMARKS	
\$					
(Some banks request that they be provided with account name and number)					

- ② The customer was directly liable to us in respect of loans, acceptances, etc., at the close of business on that date in the total amount of \$ \_\_\_\_\_, as follows:

AMOUNT	DATE		INTEREST		DESCRIPTION OF LIABILITY, COLLATERAL, SECURITY INTERESTS, LIENS, ENDORSERS, ETC.
	OF LOAN/DISCOUNT	DUE	RATE	PAID TO	
\$					

- ③ The customer was contingently liable as endorser of notes discounted and/or as guarantor at the close of business on that date in the total amount of \$ \_\_\_\_\_, as below:

AMOUNT	NAME OF MAKER	DATE		REMARKS
		OF NOTE	DUE	
\$				

- ④ Other direct or contingent liabilities, open letters of credit, and relative collateral, were:

- ⑤ Security agreements under the Uniform Commercial Code or any other agreements providing for restrictions, not noted above, were as follows (if officially recorded, indicate date and office in which filed):

• Approved 1966 by American Institute of Certified Public Accountants and Bank Administration Institute (formerly NABAC)  
Additional forms available from:  
AICPA—ORDER  
P.O. BOX 0946, NYC NY 10108-0946

Date:

Yours truly, (Bank)

By \_\_\_\_\_  
Authorized Signature — Bank

DUPLICATE  
To be retained by bank

**.05 Request for Confirmation of Petty Cash Fund and Advances to Employees**

(Prepared on client's letterhead)

(Date)

(Name)

(Address)

Dear.....:

Our auditors, (insert name and address of auditors) are performing their regular audit of our financial statements. Accordingly, please confirm directly to our auditors the balance of the petty cash fund (or amount of advances) in your possession as of December 31, 19XX which was shown by our records as \$.....

Please indicate in the space provided below whether the amount above agrees with your records. If not, please send the auditors any information you have that will help them reconcile the difference.

After signing and dating your reply, please return it directly to the auditors. A stamped, addressed envelope is enclosed for your convenience.

Very truly yours,

(Client's authorized signature)

The foregoing information is in agreement with my records as of December 31, 19XX with the following exceptions (if any):

.....  
 .....  
 .....

Date: .....

Signed: .....

**.06 Securities and Cash in Custodian or Trust Accounts**

(Prepared on client's letterhead)

(Date) [Note (A) below]

(Name of custodian or trustee)

(Address)

Dear.....:

Our auditors, (insert name and address of auditors) are performing their regular audit of our financial statements. Accordingly, please send directly to our auditors a list of our securities owned at (insert date) and the amount of principal and income cash held by you at that date for each of the following accounts [Notes (C) & (D)]:

	Name of account	Account No. [Note (B)]
1.	.....	.....
2.	.....	.....
3.	.....	.....

Please also indicate to the auditors whether to your knowledge any of the securities are pledged or otherwise encumbered.

Please mail your reply directly to the auditors. A stamped, addressed envelope is enclosed for your convenience.

Very truly yours,

(Client's authorized signature)

## NOTES TO USER:

- (A) The request should be sent so it reaches the trustees or custodians sufficiently in advance of the listing date for them to respond in a practical manner.
- (B) Use the custodian or trustee's account number.
- (C) This letter may be expanded, if necessary, to request cutoff statements of activity (principal and interest) in the accounts.
- (D) Sometimes this request is combined with a request for cutoff bank statements and a standard bank confirmation. However, it may be more practical to send separate letters because a bank's commercial banking and trust departments are usually separate operations.

**.07 Securities Held by Brokers**

(Prepared on client's letterhead)

(Date) [Note (A) below]

(Broker's Name)

(Address)

Dear.....:

In connection with their regular audit of our financial statements, please send directly to our auditors (insert name and address of auditors), a statement of our account(s) [Note (B)] with you as of (insert date), indicating the following information:

1. Securities held by you for our account.
2. Securities out for transfer to our name.
3. Any amounts payable to or due from us.

Please mail your reply directly to the auditors. A stamped, addressed envelope is enclosed for your convenience.

Very truly yours,

(Client's authorized signature)

---

NOTES TO USER:

- (A) The request should be sent so it reaches the broker sufficiently in advance of the listing date for the broker to respond in a practical manner.
- (B) It may be helpful to include the account number(s) used by the broker for the client's account(s).

**.08 Sample Receipts for Return of Cash or Securities Counted by Auditor's Representative, and Cutoff Bank Statements Received Directly by the Auditors****Cash Count**

The above detailed items were counted in my presence and returned to me intact by (insert individual's name), representative of (insert auditor's firm name).

(Date and Time)

Custodian .....  
(custodian's signature)

**Securities Count**

Received intact from (insert individual's name), representative of (insert auditor's firm name), the securities listed above contained in Box ..... of the (insert name of bank or custodian) which were counted by him in my presence (or presented to him for count).

Date and Time .....

Signed .....  
Title .....

**Cutoff Bank Statement(s)**

Received intact from (insert individual's name), representative of (insert auditor's firm name), the cutoff bank statements and related paid checks for the period from ..... to ..... (periods indicated) for the accounts listed below:

Date and Time .....

Signed .....  
Title .....

**NOTES TO USER:**

- Receipt(s) should be written and signed in *ink*.
- For counts of petty cash funds, the receipt may be written directly on the bottom of the petty cash-count working paper. For security counts and returns of cutoff bank statements, the receipt may be prepared as a separate working paper.

**.09 Accounts Receivable—Positive**

(Prepared on client's letterhead)

(Date)

(Customer's Name)

(Address)

Dear .....

In connection with their regular audit of our financial statements, please confirm directly to our auditors (insert name and address of auditors) the amount of your indebtedness to us which according to our records as of (insert date) amounted to \$.....

If the amount shown is in agreement with your records at that date, please sign in the place provided below and return this letter directly to our auditors in the enclosed envelope.

If the amount is not in agreement with your records, please note the amount shown in your records and any information which may help reconcile the difference on the back of this letter and send it directly to our auditors in the enclosed envelope.

Remittances should not be sent to the auditors.

Very truly yours,

(Client's authorized signature)

\_\_\_\_\_

The above stated amount is correct as of (insert date) with the following exceptions (if any): .....

.....

.....

(Signed by)

.....

(Title)

**NOTES TO USER:**

- The auditor should consider sending confirmation requests at the time of the client's regular monthly billings. Coordination of confirmation procedures with the client's routine preparation and mailing of statements may offer efficiency to both the auditor and client.
- Some auditors use their own standard forms for accounts receivable confirmation requests rather than correspondence prepared by the client. In such instances, it may be advisable for the form to include a prominent notice that "this is not a request for payment."



**.10 Accounts Receivable—Negative**

(May be a sticker or stamp used on client's statements to customers)

PLEASE CHECK THIS STATEMENT

If this statement is *not correct* please write promptly (using the enclosed envelope), giving details of any differences, directly to our auditors,

(Name of auditors)  
\_\_\_\_\_

(Address of auditors)  
\_\_\_\_\_

who are now conducting an audit of our financial statements.

If you do not write to our auditors, they will consider this statement to be correct.

Remittances should NOT be sent to the auditors.

---

NOTES TO USER:

- A negative confirmation may also be requested in letter form using similar wording.
- The auditor should consider sending confirmation requests at the time of the client's regular monthly billings. Coordination of confirmation procedures with the client's routine preparation and mailing of statements may offer efficiency to both the auditor and client.

**.11 Notes Receivable**

(Prepared on client's letterhead)

(Date)

(Name)

(Address)

Dear.....:

Our auditors (insert name and address of auditors) are performing their regular audit of our financial statements. Accordingly, please confirm directly to our auditors the amount of your note(s) and collateral held by us as of (insert date), and the interest rate and date to which interest has been paid, which our records show as follows:

<u>Date of Note</u>	<u>Due Date</u>	<u>Original Amount</u>	<u>Unpaid Principal</u>	<u>Interest Rate</u>	<u>Interest Paid to</u>
---------------------	-----------------	----------------------------	-----------------------------	--------------------------	-----------------------------

Collateral:

If the above information is in agreement with your records at that date, please so indicate by signing in the place provided below and return the copy of this letter directly to our auditors in the enclosed envelope.

If the above is not in agreement with your records, please note in the space provided the particulars shown in your records and any information which may help reconcile the difference from our records. Remittances should not be sent to the auditors.

Very truly yours,

(Client's authorized signature)

The above information is correct as of (insert date) with the following exceptions (if any): .....

.....  
 .....

.....  
 (Signed by)

.....  
 (Title)

**.12 Inventories Held by Warehouses or Others When Listing Is Not Provided by Client**

(Prepared on client's letterhead)

(Date)

(Name of Warehouse)

(Address)

Dear.....:

Our auditors (insert name and address of auditors) are performing their regular audit of our financial statements. Accordingly, please send directly to our auditors the following information about merchandise held in your custody for our account at (insert date):

1. Quantities on hand; for each lot please indicate the following:
  - (a) Lot number (list each lot separately)
  - (b) Date received
  - (c) Kind of merchandise
  - (d) Unit of measure or package
    - (1) Number of units
    - (2) Kind of units (box, can, crate, quart, pound, dozen, etc.)
2. A statement about how you determined the above requested quantities; specify whether they were determined by physical count, weight or measure, or if they represent your book record.
3. A list of negotiable or nonnegotiable warehouse receipts issued, if any, and whether or not such receipts have, to your knowledge, been assigned or pledged.
4. Statement of any known liens against this merchandise.
5. Amount of unpaid charges, if any, as of (insert date).

Please mail your reply directly to the auditors. A stamped, addressed envelope is enclosed for your convenience.

Very truly yours,

(Client's authorized signature)

**.13 Inventories Held by Warehouses or Others When Listing Is Provided by Client**

(Prepared on client's letterhead)

(Date)

(Name of Warehouse)

(Address)

Dear .....

Our auditors (insert name and address of auditors) are performing their regular audit of our financial statements. Accordingly, please confirm directly to our auditors the following information about the merchandise held by you for our account as of (insert date):

1. The correctness of the quantities shown on the enclosed listing of such merchandise prepared from our records (a second copy is enclosed for your files). If the enclosed listing differs from the quantities you held for us as of (insert date), please include details of the specific differences in your response to our auditors.
2. Your statement on how you determined the correctness of the quantities you are confirming; please specify whether determined by physical count, weight or measure, or whether the quantities are from your records.
3. A list of negotiable or nonnegotiable warehouse receipts issued, if any, and whether or not such receipts have, to your knowledge, been assigned or pledged.
4. Statement of any known liens against these goods.
5. Amount of any unpaid charges as of (insert date).

Please mail your reply directly to (insert name and address of auditors). A stamped, addressed envelope is enclosed for your convenience.

Very truly yours,

(Client's authorized signature)

## Correspondence, Confirmations &amp; Representations

.14

**STANDARD CONFIRMATION INQUIRY  
FOR LIFE INSURANCE POLICIES**  
Developed by  
AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS  
LIFE OFFICE MANAGEMENT ASSOCIATION  
MILLION DOLLAR ROUND TABLE

**ORIGINAL**  
To be mailed to accountant

\_\_\_\_\_19\_\_\_\_

Dear Sirs:

Please furnish the information requested below in items 1 through 9 (and also in items 10 through 12 if any of those items are checked) for the policies identified on lines A, B and C. This information is requested as of the date indicated. **IF THE ANSWER TO ANY ITEM IS "NONE," PLEASE SO STATE.** The enclosed envelope is provided for the return of one copy of this form to the accountant named below.

(Ins. Co.) \_\_\_\_\_

(Name of owner as shown on policy contracts) \_\_\_\_\_

Information requested as of \_\_\_\_\_

(Accountant) \_\_\_\_\_

Request authorized by \_\_\_\_\_

	Col. A	Col. B
<b>A.</b> Policy number		
<b>B.</b> Insured		
<b>C.</b> Beneficiaries as shown on policies (if verification requested in item 11) Col. A— Col. B—		
<b>1.</b> Face amount of basic policy	\$	\$
<b>2.</b> Values shown as of (insert date if other than date requested)		
<b>3.</b> Premiums, including prepaid premiums, are paid to (insert date)		
<b>4.</b> Policy surrender value (excluding dividends, additions and indebtedness adjustments)	\$	\$
<b>5.</b> Surrender value of all dividend credits, including accumulations and additions	\$	\$
<b>6.</b> Termination dividend currently available on surrender	\$	\$
<b>7.</b> Other surrender values available to policyowner		
a. Prepaid premium value	\$	\$
b. Premium deposit funds	\$	\$
c. Other	\$	\$
<b>8.</b> Outstanding policy loans, excluding accrued interest	\$	\$
<b>9.</b> If any loans exist, complete either "a" or "b"	\$	\$
a. Interest accrued on policy loans		
b. 1.) Loan interest is paid to (enter date)		
2.) Interest rate is (enter rate)		

The accountant will indicate by a check (✓) which if any of items 10-12 are to be answered

<input type="checkbox"/>	<b>10.</b> Is there an assignee of record? (enter Yes or No)		
<input type="checkbox"/>	<b>11.</b> Is beneficiary of record as shown in item C above? (enter Yes or No*)	*	*
<input type="checkbox"/>	<b>12.</b> Is the name of policyowner (subject to any assignment) as shown at the top of the form? (enter Yes or No) If No, enter name of policyowner of record. _____		

\*If answer to 11 is No, please give name of beneficiary or date of last beneficiary change. \_\_\_\_\_

Date \_\_\_\_\_ By \_\_\_\_\_ Title \_\_\_\_\_

For the insurance company addressed

Additional copies of this form are available from the American Institute of CPAs, 1211 Avenue of the Americas, New York, N. Y. 10036

**STANDARD CONFIRMATION INQUIRY  
FOR LIFE INSURANCE POLICIES**

Developed by  
AMERICAN INSTITUTE OF CERTIFIED PUBLIC ACCOUNTANTS  
LIFE OFFICE MANAGEMENT ASSOCIATION  
MILLION DOLLAR ROUND TABLE

**D U P L I C A T E**

To be retained by insurance company

19

Dear Sirs:

Please furnish the information requested below in items 1 through 9 (and also in items 10 through 12 if any of those items are checked) for the policies identified on lines A, B and C. This information is requested as of the date indicated. **IF THE ANSWER TO ANY ITEM IS "NONE," PLEASE SO STATE.** The enclosed envelope is provided for the return of one copy of this form to the accountant named below.

(Ins. Co.) \_\_\_\_\_

(Name of owner as shown on policy contracts)

Information requested as of \_\_\_\_\_

(Accountant) \_\_\_\_\_

Request authorized by \_\_\_\_\_

	Col. A	Col. B
<b>A. Policy number</b>		
<b>B. Insured</b>		
<b>C. Beneficiaries as shown on policies (if verification requested in item 11)</b>		
Col. A—		
Col. B—		
<b>1. Face amount of basic policy</b>	\$	\$
<b>2. Values shown as of (insert date if other than date requested)</b>		
<b>3. Premiums, including prepaid premiums, are paid to (insert date)</b>		
<b>4. Policy surrender value (excluding dividends, additions and indebtedness adjustments)</b>	\$	\$
<b>5. Surrender value of all dividend credits, including accumulations and additions</b>	\$	\$
<b>6. Termination dividend currently available on surrender</b>	\$	\$
<b>7. Other surrender values available to policyowner</b>		
a. Prepaid premium value	\$	\$
b. Premium deposit funds	\$	\$
c. Other	\$	\$
<b>8. Outstanding policy loans, excluding accrued interest</b>	\$	\$
<b>9. If any loans exist, complete either "a" or "b"</b>		
a. Interest accrued on policy loans	\$	\$
b. 1.) Loan interest is paid to (enter date)		
2.) Interest rate is (enter rate)		

The accountant will indicate by a check (✓) which if any of items 10-12 are to be answered

<input type="checkbox"/>	<b>10. Is there an assignee of record? (enter Yes or No)</b>		
<input type="checkbox"/>	<b>11. Is beneficiary of record as shown in item C above? (enter Yes or No*)</b>	*	*
<input type="checkbox"/>	<b>12. Is the name of policyowner (subject to any assignment) as shown at the top of the form? (enter Yes or No)</b>		
	If No, enter name of policyowner of record. _____		

\*If answer to 11 is No, please give name of beneficiary or date of last beneficiary change. \_\_\_\_\_

Date \_\_\_\_\_ By \_\_\_\_\_ Title \_\_\_\_\_

For the insurance company addressed

Additional copies of this form are available from the American Institute of CPAs, 1211 Avenue of the Americas, New York, N. Y. 10036

**.15A Pension Plan Actuarial Cost Information\***

(Prepared on client's letterhead)

(Date)

(Name of Actuary)

(Address)

Dear .....

Our auditors (insert name and address of auditors) are performing their regular audit of our financial statements as of (insert date) and for the (insert period) then ended. Accordingly, information is needed so we may determine the amounts of pension cost and other information to be disclosed in our financial statements in conformity with APB Opinion No. 8, as amended by FASB Statement No. 36.

In this connection, please provide our auditors with the following information about our Employees' Pension Plan (list the plans where several plans exist and are accounted for separately) as of the date when you last made an actuarial valuation of our Plan(s):

1. Date of your most recent valuation.
2. Actuarial cost method(s) used.
3. Pension cost for the most recent year, specifically:
  - a. Normal cost.
  - b. Past service cost.
  - c. Vested benefit cost (if applicable).
4. Unfunded prior service cost, if any, at most recent valuation date.
5. Prior service cost arising from amendments to the plan, if any, indicating:
  - a. Date amendment established.
  - b. Initial amount at amendment date.
  - c. Unfunded amount at most recent valuation date.
  - d. Period of amortization.
6. Interest rate used in determining costs.
7. Actuarial present value of vested accumulated plan benefits.
8. Actuarial present value of nonvested accumulated plan benefits.
9. Plan's net assets available for benefits (indicate basis of valuation).
10. Assumed rates of return used in determining the actuarial present values of vested and nonvested accumulated plan benefits.
11. Net annual actuarial gain or loss for most recent year, if separately calculated. Indicate method of recognizing such gains and losses in present or future actuarial determinations.

---

\* This illustrative letter for obtaining pension plan cost actuarial information reflects the requirements of Accounting Principles Board Opinion No. 8, *Accounting for the Cost of Pension Plans*. This letter should be followed if the enterprise is following APB Opinion No. 8. If the enterprise is following FASB Statement of Financial Accounting Standards No. 87, *Employers' Accounting for Pensions*, then refer to AAM section 7200.15B for an illustrative letter.

12. Basis and extent of recognition, if any, of unrealized appreciation and depreciation of pension fund investments in actuarial determinations.
13. Minimum age or length of service, if any, used to exclude employees from basis for actuarial determinations, and your estimate of the effect of those exclusions on the pension cost calculations.
14. A description of any changes since your previous review or report in the matters covered by Items 2, 4 and 5 (re: period of amortization), 6, 9 (re: basis of valuation), 11 (re: method of recognition), 12 and 13.
15. A description of any changes in actuarial assumptions and/or cost method used, and their approximate total dollar effect on annual pension cost.
16. A statement as to whether your responses to the above items, in your opinion as actuaries for the Plan(s), have been made in accordance with the related provisions of APB Opinion No. 8, as amended by FASB Statement No. 36. If not, describe the specific difference(s).
17. A statement as to whether, in your opinion, the plan conforms to the requirements of ERISA.

A copy of your report covering the above items will suffice. If some of the above items are not covered in the report, please provide supplementary data.

Please mail your reply directly to our auditors. A stamped, addressed envelope is enclosed for your convenience.

Very truly yours,

(Client's authorized signature)



**.15B Pension Plan Actuarial Information\***

(Prepared on client's letterhead)

(Date)

(Name of Actuary)

(Address)

Dear.....:

In connection with the audit of our financial statements for the period ending (*fiscal year end*) by our independent auditors (name, address), please furnish them the information described below as it pertains to the XYZ Pension Plan, which is a defined benefit plan. For your convenience in response to those requests, you may supply pertinent sections, properly signed and dated, of your actuarial report, or pension expense report, if they are available and if they contain the requested information.

A. Please provide a brief description of the following:

1. The employee group covered.
2. The benefit provisions of the plan used in the calculation of the net periodic pension cost for the period and of the accumulated benefit obligation and the projected benefit obligation at the end of the period. Please identify any such benefit provisions that had not taken effect in the year. Please also provide the date of the most recent plan amendment included in your calculation. Please identify any participants or benefits excluded from the calculations, such as benefits guaranteed under an insurance or annuity contract.
3. The plan sponsor's funding policy for the plan.
4. Any significant liabilities other than for benefits, such as for legal or accounting fees.
5. The method and the amortization period, if any, used for the following:
  - a. Calculation of a market-related value of plan assets, if different from the fair value.
  - b. Amortization of any transition asset or obligation.
  - c. Amortization of unrecognized prior service cost.
  - d. Amortization of unrecognized net gain or loss.
6. Any substantive commitments for benefits that exceed the benefits defined by the written plan that are included in the calculations.
7. Determination of the value of any insurance or annuity contracts included in the assets.
8. Nature and effect of significant plan amendments and other significant matters affecting comparability of net periodic pension cost, funded status, and other information for the current period with that for the prior period.
9. The following information relating to the employee census data used in calculating the benefit obligations and pension cost:

---

\* This illustrative letter for obtaining pension plan actuarial information has been updated to reflect the requirements of FASB Statement of Financial Accounting Standards No. 87, *Employers' Accounting for Pensions*. This letter may be used if the enterprise is following FASB Statement No. 87. If the enterprise is not yet following FASB Statement No. 87 and is still following Accounting Principles Board Opinion No. 8, *Accounting for the Cost of Pension Plans*, then refer to AAM section 7200.15A for an illustrative letter.

- a. The source and nature of the data is \_\_\_\_\_ and the date as of which the census data was collected is \_\_\_\_\_.
- b. The following information concerning participants:

<u>Participants</u>	<u>Number of Persons</u>	<u>Compensation (if applicable)</u>
Currently receiving payments	_____	_____
Active with vested benefits	_____	_____
Terminated with deferred vested benefits	_____	_____
Active without vested benefits	_____	_____
Other (describe)	_____	_____

*Note: If information is not available for all the above categories, please indicate the categories that have been grouped and describe any group or groups of participants excluded from the above information.*

- c. Information for the following individuals contained in the census:

<u>Participants' Name or Number</u>	<u>Age or Birth Date</u>	<u>Sex</u>	<u>Salary</u>	<u>Date Hired or Years of Service</u>
---	------------------------------	------------	---------------	---

*Note to Auditor: The auditor should select information from employer records to compare with the census data used by the actuary. In addition, the auditor may wish to have the actuary select certain census data from his files to compare with the employer's records.*

- B. Please provide the following information on the net periodic pension cost for the period ending on \_\_\_\_\_ :

1. Service cost \$ \_\_\_\_\_

2. Interest cost

3. Actual return on assets

4. Other components

a. Net asset gain or (loss) during the period deferred for later recognition

b. Amortization of net loss or (gain) from earlier periods

c. Amortization of unrecognized prior service cost

d. Amortization of the remaining unrecognized net obligation or (asset) existing at the date of the initial application of FASB Statement No. 87—transition obligation or (asset)

e. Net total of components

(a + b + c + d)

5. Net periodic pension cost:  
(1 + 2 - 3 + 4e)

\$ \_\_\_\_\_

6. The above measurement of the net periodic pension cost is based on the following assumptions:

Weighted-average discount rate

\_\_\_\_\_ %

Weighted-average rate of compensation increase

\_\_\_\_\_ %

Weighted-average expected long-term rate of return on plan assets

\_\_\_\_\_ %

Please describe the basis on which the above rates were selected and whether the basis is consistent with the prior period.

Please briefly describe the other assumptions used in the above measurement.

7. The calculations of the items shown in B1 to B5 are based on the following:

Asset information at \_\_\_\_\_

Census data at \_\_\_\_\_

Measurement date (must be not more than three months before the end of the last fiscal year) \_\_\_\_\_

Please describe any adjustments made to project the census data forward to the measurement date or to project the results calculated at an earlier date to those shown in B1 to B5.

- C. Please provide the following information on the benefit obligations for disclosure in the financial statements for the period ending \_\_\_\_\_:

*Estimated*

1. Pension Benefit Obligation

- a. Accumulated benefit obligation

—vested

—non vested

—total

\$

- b. Additional benefits based on estimated future salary levels

- c. Projected benefit obligation (a + b)

2. Fair Value of Plan Assets

3. Unfunded Projected Benefit Obligation:  
(1c - 2)

4. Unrecognized Prior Service Cost

5. Unrecognized Net Loss or (Gain)

6. Unrecognized Net Transition Liability or (Asset)

7. Additional Liability

8. Accrued or (prepaid) pension cost in the company financial statements  
(3 - 4 - 5 - 6 + 7)

\$

9. The above amount of the projected benefit obligation is measured based on the following assumptions:

Weighted-average discount rate \_\_\_\_\_%

Weighted-average rate of compensation increase \_\_\_\_\_%

Please provide a brief description of the other assumptions used in the measurement.

10. The calculation of the items shown in C1 to C8 is based on the following:

Asset information at \_\_\_\_\_

Census data at \_\_\_\_\_

Measurement date (must be not more than three months before the current fiscal year end) \_\_\_\_\_

Please describe any adjustments made to project the census data forward to the measurement date or to project the results calculated at an earlier date to those shown in C1 to C8.

11. Please describe any significant events noted subsequent to the current year's measurement date and as of the date of your reply to this request and the effects of those events, such as a large plant closing, which could materially affect the amounts shown in C1 to C8.

- D. Please provide an analysis for the period showing beginning amounts, additions, reductions, and ending amounts of the:

1. Projected benefit obligation,
2. Unrecognized prior service cost,
3. Unrecognized net loss (gain), and
4. Net transition obligation (asset).

- E. Please provide our independent auditors with descriptions and the amounts of gains or losses from settlements, curtailments or termination benefits during the year, such as:
1. Purchases of annuity contracts,
  2. Lump-sum cash payments to plan participants,
  3. Other irrevocable actions that relieved the company or the plan of primary responsibility for a pension obligation, and eliminates significant risks related to the obligation and assets,
  4. Any events that significantly reduced the expected years of future service of employees,
  5. Any events that eliminated for a significant number of employees the accrual of defined benefits for some or all of their future service, or
  6. Any special or contractual termination benefits offered to employees.
- F. Was all of the information above determined in accordance with FASB Statements No. 87 and No. 88 (including the FASB's Guides to Implementation of Statements 87 and 88 and the American Academy of Actuaries', "An Actuary's Guide to Compliance with Statement of Financial Accounting Standards No. 87") to the best of your knowledge? If not, please describe any differences.
- G. Describe the nature of your relationship, if any, with the plan or the plan sponsor that may impair or appear to impair the objectivity of your work.

Very truly yours,

---

**.16 Pension Plan Assets Held by Trustee**

(Prepared on client's letterhead)

(Date)

(Name of trustee or custodian)

(Address)

Dear .....

Our auditors (insert name and address of auditor) are now auditing our financial statements. Accordingly, please provide our auditors directly with a listing of the assets including market values as of (insert date) for our employees' pension trust (insert title and trustee's account number).

Please also provide the auditors with the following information about our employees' pension trust for the period from (insert date) to (insert date) [see note below]:

1. Contributions by the Company during the above period.
2. Contributions by employees during the above period.
3. Payments to beneficiaries during the above period.
4. Any unpaid fees due for services rendered to (insert audit date).

Please send your reply directly to our auditors. A stamped, addressed envelope is enclosed for your convenience.

Very truly yours,

(Client's authorized signature)

---

**NOTE TO USER:**

A listing of the assets might not be requested if one had already been received by the client. In that case, the auditor might want the trustee to confirm the total market value per the listing.

**.17 Notes Payable**

(Prepared on client's letterhead)

(Date)

(Name)

(Address)

Dear.....:

Our auditors (insert name and address) are performing their regular audit of our financial statements.

Accordingly, please confirm directly to them the following information relating to our note(s) payable to you, as of (insert date):

Date of Note: (insert date)

Original Amount: (insert amount)

Unpaid Principal

Balance: (insert amount)

Maturity Date: (insert date)

Interest Rate: (insert rate)

Date to which interest has been paid: (insert date)

Amount and description of collateral: (insert description)

Any other direct or contingent liabilities to you: (insert "None" or description)

If the above information is in agreement with your records at that date, please so indicate by signing in the place provided below and return the copy of this letter directly to our auditors in the enclosed envelope.

If the above is not in agreement with your records, please note in the space provided the particulars shown in your records and any information which may help reconcile the difference from our records.

Very truly yours,

(Client's authorized signature)

The above information is correct as of (insert date) with the following exceptions (if any): .....

Date .....

Signature .....

Title .....

**NOTE TO USER:**

Banks would ordinarily confirm this information in connection with the Standard Bank Confirmation form. Depending upon the note agreement, however, additional items may need to be requested.

**.18 Mortgage Debt**

(Prepared on client's letterhead)

(Date)

(Name of creditor or trustee)

(Address)

Dear .....

Our auditors (insert name and address of auditors) are now performing their regular annual audit of our financial statements. In this connection, please confirm directly to our auditors the following information about our mortgage indebtedness to you as of (insert date):

1. Unpaid principal balance.
2. Interest rate.
3. Terms for payment of principal.
4. Date to which interest has been paid.
5. Nature of mortgage and description or address of property mortgaged.
6. Amounts on deposit with you in escrow for:
  - a. Insurance
  - b. Real estate taxes
7. Amounts paid during the period (insert dates from and to) for:
  - a. Insurance
  - b. Taxes
8. Amounts on deposit with you for the "reserve for repairs."
9. The nature of defaults, if any.

A return envelope is enclosed for your reply.

Very truly yours,

(Client's authorized signature)

---

**NOTE TO USER:**

Many of the items requested will vary with the circumstances of the particular mortgage or other debt involved. The above sample assumes the indenture involves an escrow arrangement for insurance and real estate taxes and a deposit account for repairs.

**.19 Accounts Payable**

(Prepared on client's letterhead)

(Date)

(Name)

(Address)

Dear .....

In connection with their regular audit of our financial statements, please confirm directly to our auditors (insert name and address of auditors), whether or not there is a balance due you as of (insert date). If there is a balance due, please indicate the amount in the space provided below and attach a statement of the items making up the balance.

Please mail your reply directly to (name of auditors). A stamped, addressed envelope is enclosed for your convenience.

Very truly yours,

(Client's authorized signature)

Our records indicate that a balance of \$..... was due from (insert name of client) at (insert date) as itemized in the attached statement.

Date.....

Signed .....

Title .....



**.20 Obligation to Lessor**

(Prepared on client's letterhead)

(Date)

(Name of lessor)

(Address)

Dear .....

Our auditors (insert name and address of auditors) are performing their regular audit of our financial statements as of (insert balance sheet date) and for the (insert time period) then ended. In connection with this audit, please provide directly to our auditors the following information as of (insert balance sheet date) regarding the lease dated (insert date lease was executed) of (insert brief identification of property under lease) which we are leasing from you:

1. Inception and expiration dates for the lease period, from ..... to .....
2. Amount of monthly rent .....
3. Renewal options (if any):
  - a. Dates of renewal period, from ..... to .....
  - b. Amount of monthly rent for renewal .....
4. Purchase options (if any):
  - a. Amount of purchase price .....
  - b. Inception and expiration dates of option, from ..... to .....
  - c. Percent of monthly rent (if any) applicable towards purchase price .....
5. Dates and descriptions of amendments or supplementary understandings, if any, to the lease mentioned above.
6. The amount of outstanding delinquent payments, if any.
7. A statement that there are no defaults, or the nature of defaults, if any.

A return envelope is enclosed for your reply.

Very truly yours,

(Client's authorized signature)

**NOTE TO USER:**

The content of this type of letter will vary based on the auditor's professional judgment in the circumstances. To provide additional illustrative language, the above letter is not made parallel with the illustration at AAM section 7200.21.

**.21 Property Out on Lease**

(Prepared on client's letterhead)

(Date)

(Name of Lessee)

(Address)

Dear .....

Our auditors (insert name and address of auditors) are conducting their regular audit of our financial statements as of (insert balance sheet date) and for the (insert time period) then ended. In connection with this audit, please confirm directly to our auditors the following information regarding the lease dated (insert execution date of lease) of (insert brief identification of property under lease) which you are leasing from us:

1. Inception and expiration dates of lease period from ..... to .....
2. Amount of monthly rent .....
3. Total rental payments made .....
4. Date of last payment .....

A return envelope is enclosed for your reply.

Very truly yours,

(Client's authorized signature)

---

**NOTES TO USER:**

- If the leased property is of a mobile or portable nature such as a bulldozer or television camera, the confirmation may also include a request for specific serial numbers of significant equipment.
- In certain circumstances, the auditor may wish to consider confirming additional information such as renewal options, purchase options, and amendments or supplementary understandings.

**.22 Registrar—Capital Stock**

(Prepared on client's letterhead)

(Date)

(Name of Registrar)

(Address)

Dear .....:

Our auditors (insert name and address of auditors) are performing their regular audit of our financial statements. Accordingly, please confirm directly to our auditors the following information as of the close of business (insert balance sheet date) about each class of our preferred and common stock:

1. Authorized number of shares
2. Issued number of shares
3. Outstanding number of shares

Please also indicate the amount of any unpaid registrar fees due you as of (insert balance sheet date).

A return envelope is enclosed for your convenience.

Very truly yours,

(Authorized signature for client)

---

**NOTES TO USER:**

- It may be helpful to include the registrar's account number for the client's account to receive a timely response.
- Some auditors prefer that the confirmation request include identification of each class of stock.
- The above illustration assumes the client has a separate transfer agent (see AAM section 7200.23).

**.23 Transfer Agent—Capital Stock**

(Prepared on client's letterhead)

(Date)

(Name of Transfer Agent)

(Address)

Dear .....

Our auditors (insert name and address of auditors) are performing their regular audit of our financial statements. Accordingly, please confirm directly to our auditors the following information as of (insert balance sheet date) about each class of our preferred and common stock:

1. Authorized number of shares
2. Number of shares issued and outstanding
3. Number of outstanding shares registered in the name of our Company.

Please also indicate the amount of any unpaid transfer agent fees due you as of (insert balance sheet date).

A return envelope is enclosed for your convenience.

Very truly yours,

(Authorized signature for client)

---

**NOTES TO USER:**

- It may be helpful to include the transfer agent's account number for the client's account to receive a timely response.
- Some auditors prefer that the confirmation request include identification of each class of stock.
- Depending on the auditor's judgment in the circumstances the confirmation request may also include inquiries about such matters as (i) the number of shares issued to each of specifically mentioned officers and directors, (ii) specified information about shareholders owning more than a stated percent of the total outstanding shares, and (iii) amounts deposited during the year for the payment of dividends.

**.24 Request for Confirmation of Money Market Fund**

(Prepared on client's letterhead)

(Date)

(Name)

(Address)

Dear .....

Our auditors, (insert name and address of auditors) are performing their regular audit of our financial statements. Accordingly, please confirm directly to our auditors the balance of our money market fund account(s) as of (insert date).

Please indicate in the space provided below the account number(s) and balance(s) of our account(s) per your records.

Please sign and date your reply and return it directly to the auditors. A stamped, self-addressed envelope is enclosed for your convenience.

Very truly yours,

(Client's authorized signature)

*Account No.**Date**Balance*

.....  
 .....  
 .....

Date: ..... Signed: .....

[The next page is 7301.]

# AAM Section 7300

## *Inquiries to Legal Counsel*<sup>1</sup>

### .01 Illustrative Inquiry Letter to Legal Counsel<sup>2</sup>

(Prepared on client's letterhead—See Note A)

Date (See Note B)

(Name of lawyer)

(Address of lawyer)

Dear .....

In connection with an audit of our financial statements at (balance sheet date) and for the (period) then ended, management of the Company has prepared, and furnished to our auditors (name and address of auditors), a description and evaluation of certain contingencies, including those set forth below involving matters with respect to which you have been engaged and to which you have devoted substantive attention on behalf of the Company in the form of legal consultation or representation. These contingencies are regarded by management of the Company as material for this purpose (management may indicate a materiality limit if an understanding has been reached with the auditor). Your response should include matters that existed at (balance sheet date) and during the period from that date to the date of your response.

#### **Pending or Threatened Litigation**

(excluding unasserted claims)

[Ordinarily the information would include the following: (1) the nature of the litigation, (2) the progress of the case to date, (3) how management is responding or intends to respond to the litigation (for example, to contest the case vigorously or to seek an out-of-court settlement), and (4) an evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss.]

Please furnish to our auditors such explanation, if any, that you consider necessary to supplement the foregoing information, including an explanation of those matters as to which your views may differ from those stated and an identification of the omission of any pending or threatened litigation, claims, and assessments or a statement that the list of such matters is complete.

#### **Unasserted Claims and Assessments**

(considered by management to be probable of assertion, and that, if asserted, would have at least a reasonable possibility of an unfavorable outcome)

[Ordinarily management's information would include the following: (1) the nature of the matter, (2) how management intends to respond if the claim is asserted, and (3) an evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss.]

<sup>1</sup> If a client has not needed to retain legal counsel, the auditor may express an unqualified opinion on the financial statements even though he has not obtained a letter from legal counsel of the Company. In these circumstances, the auditor should obtain written representation from the Company that legal counsel has not been retained for matters concerning business operations that may involve current or prospective litigation (see AICPA *Technical Practice Aids*, section 9320.07).

<sup>2</sup> Extracted from the Appendix to Statement on Auditing Standards No. 12, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments* [AU section 337A]. [See Note B.]

Please furnish to our auditors such explanation, if any, that you consider necessary to supplement the foregoing information, including an explanation of those matters as to which your views may differ from those stated.

We understand that whenever, in the course of performing legal services for us with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, if you have formed a professional conclusion that we should disclose or consider disclosure concerning such possible claim or assessment, as a matter of professional responsibility to us, you will so advise us and will consult with us concerning the question of such disclosure and the applicable requirements of Statement of Financial Accounting Standards No. 5. Please specifically confirm to our auditors that our understanding is correct.

Please specifically identify the nature of and reasons for any limitation on your response.

[The auditor may request the client to inquire about additional matters, for example, unpaid or unbilled charges or specified information on certain contractually assumed obligations of the company, such as guarantees of indebtedness of others.]

Very truly yours,

(Authorized signature for client)

---

NOTES TO USER:

- (A) Auditors should carefully consider the provisions of SAS No. 12 [AU section 337] in drafting this letter.
- (B) Sending of this letter should be timed so that the lawyer's response is dated as close to the auditor's opinion date as practicable. However, the auditor and client should consider early mailing of a draft inquiry as a convenience for the lawyer in preparing a timely response to the formal inquiry letter.

**.02 Illustrative Inquiry Letter to Legal Counsel If Management Has Not Provided Details About Pending or Threatened Litigation**

(Prepared on client's letterhead—See Note A)

Date (See Note B)

(Name of lawyer)

(Address of lawyer)

Dear .....

In connection with an audit of our financial statements at (balance sheet date) and for the (period) then ended, please furnish to our auditors (name and address of auditors), the information requested below with respect to which you have been engaged and to which you have devoted substantive attention on behalf of the Company in the form of legal consultation or representation. Your response should include matters that existed at (balance sheet date) and during the period from that date to the date of your response.

**Pending or Threatened Litigation**

(excluding unasserted claims)

Please prepare a description of all litigation, claims, and assessments (excluding unasserted claims and assessments) involving amounts exceeding (amount) individually or lesser amounts that exceed (amount) in the aggregate. The description of each case should include—

1. The nature of the litigation.
2. The progress of the case to date.
3. How management is responding or intends to respond to the litigation (e.g., to contest the case vigorously or to seek an out-of-court settlement).
4. An evaluation of the likelihood of an unfavorable outcome and an estimate, if one can be made, of the amount or range of potential loss.

**Unasserted Claims and Assessments**

We understand that whenever, in the course of performing legal services for us with respect to a matter recognized to involve an unasserted possible claim or assessment that may call for financial statement disclosure, you have formed a professional conclusion that we should disclose or consider disclosure concerning such possible claim or assessment, you will so advise us and will consult with us concerning the question of such disclosure and the applicable requirements of Statement of Financial Accounting Standards No. 5, as a matter of professional responsibility to us. *Please specifically confirm to our auditors that our understanding is correct.*

We have represented to our auditors that you have not advised us of any unasserted claims or assessments that are probable of assertion and must be disclosed in accordance with Statement of Financial Accounting Standards No. 5.

**Other Matters**

1. Please specifically identify the nature of and reasons for any limitation on your response.
2. Please indicate the amount owed to you for services and expenses (billed and unbilled) at (balance sheet date).



Very truly yours,

(Authorized signature for client)

---

NOTES TO USER:

- (A) Auditors should carefully consider the provisions of SAS No. 12, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments* [AU section 337] in drafting this letter.
- (B) Sending of this letter should be timed so that the lawyer's response is dated as close to the auditor's opinion date as practicable. However, the auditor and client should consider early mailing of a draft inquiry as a convenience for the lawyer in preparing a timely response to the formal inquiry letter.

### .03 Improving Inquiry Techniques

If inquiries to legal counsel are not sufficiently detailed or specific, deficiencies in attorneys' responses may result. A conference between the auditor and the attorney may be necessary to clarify the attorney's written response and SAS No. 12, *Inquiry of a Client's Lawyer Concerning Litigation, Claims, and Assessments*, paragraph 10 [AU section 337.10] provides for such a conference. However, to improve the auditor's ability to receive all of the information necessary to complete his audit, he may wish to consider including the following matters in an inquiry to legal counsel:

- a. A request that the attorney specify the effective date of his response if it is other than the date of his reply.
  - b. A request that the attorney mail his response so that it will be received by a certain date.
  - c. A request that the nature of any litigation specifically identify (i) the proceedings, (ii) the claim(s) asserted, (iii) the amount of monetary damages sought, or if no amounts are indicated in preliminary case filings, a statement to that effect, and (iv) the objectives sought by the plaintiff, if any, other than monetary or other damages, such as performance or discontinued performance of certain actions.
  - d. A request that the attorney avoid such vague phrases as "meritorious defenses," "without substantial merit," and "reasonable chance" in expressing an opinion on the outcome of litigation.
  - e. If an opinion cannot be expressed on the outcome of litigation, a request that the attorney so state together with his reasons for that position.
  - f. A request that the attorney specify to what extent potential damages are covered by insurance. (It may be possible to obtain the opinion of the insurer's counsel regarding the applicability of insurance coverage.)
  - g. A request that the attorney provide a summary of material litigation, claims, and assessments settled during the period.
  - h. A statement that confirmation of the understanding regarding disclosure of unasserted claims and assessments is an integral part of the audit inquiry and that failure to so confirm will require a follow-up contact.
  - i. A statement that the attorney's response will not be quoted or referred to in the financial statements without first consulting with him.
- 

[The next page is 7401.]



# AAM Section 7400

## *Representation Letters*

### .01 Illustrative Representation Letter—Audit of Financial Statements

**Introductory Comment** (Extracted from the Appendix to SAS No. 19, *Client Representations* [AU section 333A])

The following letter is presented for illustrative purposes only. The written representations to be obtained should be based on the circumstances of the engagement and the nature and basis of presentation of the financial statements being audited. The introductory paragraph should specify the financial statements and periods covered by the auditor's report, for example, "balance sheets of XYZ Company as of December 31, 19X1 and 19X0, and the related statements of income and retained earnings and cash flows for the years then ended." Similarly, representations concerning inventories and sales and purchase commitments would not be obtained if such items are not material to the company's financial position and results of operations or if they are not recorded in the financial statements under a comprehensive basis of accounting other than generally accepted accounting principles, for example, financial statements prepared on the cash basis of accounting.

The illustrative letter assumes that there are no matters requiring specific disclosure to the auditor. If such matters exist, they should be indicated by listing them following the representation, by reference to accounting records or financial statements, or by other similar means. For example, if an event subsequent to the date of the balance sheet has been disclosed in the financial statements, item 14 could be modified as follows: "Except as discussed in Note X to the financial statements, no events have occurred. . . ." Similarly, in appropriate circumstances, item 4 could be modified as follows: "We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities, except that certain marketable securities have been excluded from current assets based on our intention not to dispose of them, which is supported by the minutes of the December 7, 19X1, meeting of the board of directors."

Certain terms are used in the illustrative letter that are defined elsewhere in authoritative literature, for example, irregularities (SAS No. 53, *The Auditor's Responsibility to Detect and Report Errors and Irregularities* [AU section 316]) and related parties (SFAS 57, *Related Party Disclosures*, paragraph 24f [AC R36.406]). To avoid misunderstanding concerning the meaning of such terms, the auditor may wish to furnish those definitions to the client and request that the client include the definitions in the written representations.

The illustrative letter assumes that management and the auditor have reached an understanding on the limits of materiality for purposes of the written representations. However, it should be noted that a materiality limit would not apply for certain representations, as explained in SAS No. 19, paragraph 5 [AU section 333.05].

**Illustrative Representation Letter** (Extracted from the Appendix to SAS No. 19 [AU section 333A])

(Prepared on client's letterhead)

(Date of Auditor's Report)

(To Independent Auditor)

In connection with your audit of the (identification of financial statements) of (name of client) as of (date) and for the (period of examination) for the purpose of expressing an opinion as to whether the (consolidated) financial statements present fairly the financial position, results of operations, and cash flows, in all material respects, of (name of client) in conformity with generally accepted accounting principles (other comprehensive basis of accounting), we confirm, to the best of our knowledge and belief, the following representations made to you during your audit.

1. We are responsible for the fair presentation in the (consolidated) financial statements of financial position, results of operations, and cash flows in conformity with generally accepted accounting principles (other comprehensive basis of accounting).
2. We have made available to you all—
  - a. Financial records and related data.
  - b. Minutes of the meetings of stockholders, directors, and committees of directors, or summaries of actions of recent meetings for which minutes have not yet been prepared.
3. There have been no—
  - a. Irregularities involving management or employees who have significant roles in the internal control structure.
  - b. Irregularities involving other employees that could have a material effect on the financial statements.
  - c. Communications from regulatory agencies concerning noncompliance with, or deficiencies in, financial reporting practices that could have a material effect on the financial statements.
4. We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.
5. The following have been properly recorded or disclosed in the financial statements:
  - a. Related party transactions and related amounts receivable or payable, including sales, purchases, loans, transfers, leasing arrangements, and guarantees.
  - b. Capital stock repurchase options or agreements or capital stock reserved for options, warrants, conversions, or other requirements.
  - c. Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances and line-of-credit or similar arrangements.
  - d. Agreements to repurchase assets previously sold.
6. There are no—
  - a. Violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency.
  - b. Other material liabilities or gain or loss contingencies that are required to be accrued or disclosed by Statement of Financial Accounting Standards No. 5 [AC section C59].
7. There are no unasserted claims or assessments that our lawyer has advised us are probable of assertion and must be disclosed in accordance with Statement of Financial Accounting Standards No. 5 [AC section C59].
8. There are no material transactions that have not been properly recorded in the accounting records underlying the financial statements.
9. Provision, when material, has been made to reduce excess or obsolete inventories to their estimated net realizable value.
10. The company has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged.
11. Provision has been made for any material loss to be sustained in the fulfillment of, or from inability to fulfill, any sales commitments.

12. Provision has been made for any material loss to be sustained as a result of purchase commitments for inventory quantities in excess of normal requirements or at prices in excess of the prevailing market prices.

13. We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.

14. No events have occurred subsequent to the balance sheet date that would require adjustment to, or disclosure in, the financial statements.

.....  
(Name of Chief Executive  
Officer and Title)

.....  
(Name of Chief Financial  
Officer and Title)

---

NOTES TO USER:

This illustration is only one example of a representation letter. Alternate wording is permissible and it may be advisable to tailor the letter to the needs of an engagement. (See "Management representation letters—adapting them to the circumstances," by Brian Zell and Douglas R. Carmichael, Professional Notes, *Journal of Accountancy*, March 1979, pages 87—90.)

A booklet entitled *The Representation Letter* (New York, AICPA, 1978) explains to clients the purpose of representation letters.

**.02 Illustrative Representation Letter—Review of Financial Statements****Introductory Comment**

For reviews of financial statements, the following guidance is set forth in Statement on Standards for Accounting and Review Services (SSARS) No. 1, *Compilation and Review of Financial Statements*, paragraph 31 [AR section 100.31]:

The accountant may wish to obtain a representation letter from the owner, manager, or chief executive officer, and if appropriate, the chief financial officer.

The following comment is set forth in SSARS No. 1, Appendix D [AR section 100.55]:

A review of financial statements consists principally of inquiries of company personnel and analytical procedures applied to financial data. Because a review does not contemplate tests of accounting records and of responses to inquiries by obtaining corroborating evidential matter, among other things, the accountant may consider it advisable to obtain a written representation from his client to confirm the oral representations made to him. The following representation letter is included for illustrative purposes only. The accountant may decide, based on the circumstances of his review engagement, that other matters should be specifically included in the letter and that some of the representations included in the illustrative letter are not necessary.

**Illustrative Representation Letter (from SSARS No. 1, Appendix D)**

(Prepared on client's letterhead)

(Date of Accountant's Report)

(To the Accountant)

In connection with your review of the (identification of financial statements) of (name of client) as of (date) and for the (period of review) for the purpose of expressing limited assurance that there are no material modifications that should be made to the statements in order for them to be in conformity with generally accepted accounting principles, we confirm, to the best of our knowledge and belief, the following representations made to you during your review.

1. The financial statements referred to above present the financial position, results of operations, and cash flows of (name of client) in conformity with generally accepted accounting principles. In that connection, we specifically confirm that—
  - a. The company's accounting principles, and the practices and methods followed in applying them, are as disclosed in the financial statements.
  - b. There have been no changes during the (period reviewed) in the company's accounting principles and practices.
  - c. We have no plans or intentions that may materially affect the carrying value or classification of assets and liabilities.
  - d. There are no material transactions that have not been properly reflected in the financial statements.
  - e. There are no material losses (such as from obsolete inventory or purchase or sales commitments) that have not been properly accrued or disclosed in the financial statements.

- f. There are no violations or possible violations of laws or regulations whose effects should be considered for disclosure in the financial statements or as a basis for recording a loss contingency, and there are no other material liabilities or gain or loss contingencies that are required to be accrued or disclosed.
  - g. The company has satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged.
  - h. There are no related party transactions or related amounts receivable or payable that have not been properly disclosed in the financial statements.
  - i. We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
  - j. No events have occurred subsequent to the balance sheet date that would require adjustment to, or disclosure in, the financial statements.
- 2. We have advised you of all actions taken at meetings of stockholders, board of directors, and committees of the board of directors (or other similar bodies, as applicable) that may affect the financial statements.
  - 3. We have responded fully to all inquiries made to us by you during your review.

.....  
(Name of Owner or Chief  
Executive Officer and Title)

.....  
(Name of Chief Financial Officer  
and Title, where applicable)



**.03 Illustrative Representation Letter—Personal Financial Statements**

[Date of accountant's report]

[To the accountant]

In connection with your [compilation, review, or audit] of the statement of financial condition and the related statement of changes in net worth of James and Jane Person as of [date] and for the [period] then ended for the purpose of [description], we confirm, to the best of our knowledge and belief, the following representations made to you during your [compilation, review, or audit].

1. We are responsible for the fair presentation in the statements of financial condition and changes in net worth in conformity with generally accepted accounting principles. All assets are presented at their estimated current values and all liabilities are presented at their estimated current amounts, which have been determined in accordance with guidelines promulgated by the American Institute of Certified Public Accountants. (Because of our limited expertise with generally accepted accounting principles, including financial statement disclosure, we have engaged you to advise us in fulfilling that responsibility.)
2. We have made all financial records and related data available to you. We have not knowingly withheld from you any financial records or related data that in our judgment would be relevant to your [compilation, review, or audit].
3. The following have been properly recorded or disclosed in the financial statements:
  - a. Related party transactions and related amounts receivable or payable, including sales, purchases, loans, transfers, leasing arrangements, and guarantees. I understand that related parties include members of my family as well as business entities in which I, or members of my family, have an investment that allows the exercise of control or significant influence.
  - b. Arrangements with financial institutions involving compensating balances or other arrangements involving restrictions on cash balances and line-of-credit or similar arrangements.
  - c. Agreements to repurchase assets previously sold.
4. There are no violations or possible violations of laws or regulations that have come to our attention whose effects are regarded as significant enough to be considered for disclosure in the financial statements or as a basis for recording a loss contingency, and there are no other material liabilities or gain or loss contingencies that are required to be accrued or disclosed.
5. There are no material transactions or balances that have not been properly recorded or disclosed in the financial statements.
6. We have satisfactory title to all owned assets, and there are no liens or encumbrances on such assets nor has any asset been pledged.
7. We have not retained an attorney for matters that may involve current or prospective litigation, and we are not aware of any pending or threatened litigation, claims, or assessments that should be disclosed in the financial statements.
8. We have complied with all aspects of contractual agreements that would have a material effect on the financial statements in the event of noncompliance.
9. No events have occurred subsequent to the date of the statement of financial condition that would require adjustment to, or disclosure in, the financial statements.

10. We have responded fully to all inquiries made to us by you during the engagement.

---

(James Person)

---

(Jane Person)

[Source: AICPA *Personal Financial Statements Guide*.]

---



## AAM Section 9000

## REVIEW AND REPORT PROCESSING

This manual is a nonauthoritative kit of practice aids and, accordingly, does not include extensive explanation or discussion of authoritative pronouncements. Users of this manual are urged to refer directly to applicable authoritative pronouncements when appropriate.

The exhibits are for illustrative purposes only. They are included as conveniences for users of this manual who may want points of reference when reviewing the working papers or preparing the report.

The material in this section has been extracted from the MAP Handbook and has been edited for this manual.

## TABLE OF CONTENTS

<i>Section</i>		<i>Paragraph</i>
9100	Supervision and Review Procedures .....	.01-.24
	Introduction .....	.01-.02
	Importance of the Supervision and Review .....	.03-.05
	Authoritative Literature .....	.06-.07
	Review Organization .....	.08-.09
	Firm Policy and Procedures Regarding Supervision and Review .....	.10-.14
	Phases of Supervision and Review .....	.15-.17
	Supervision and Review of Fieldwork .....	.18-.20
	Overall Review Phase .....	.21-.24
9210	Partner's Engagement Review Program .....	.010-.210
	I. Functional Areas .....	.010-.060
	A. Independence .....	.010
	B. Assigning Personnel to Engagements .....	.020
	C. Consultation .....	.030
	D. Supervision .....	.040
	E. Professional Development .....	.050
	F. Acceptance and Continuance of Clients .....	.060
	II. General Procedures .....	.070
	A. General .....	.070
	III. Working Paper Areas .....	.080-.210
	A. Cash .....	.080
	B. Receivables .....	.090
	C. Inventories .....	.100
	D. Investments .....	.110
	E. Prepaid Expenses, Intangible Assets, Deferred Charges, Etc. ....	.120
	F. Property, Plant, and Equipment .....	.130
	G. Current Liabilities .....	.140
	H. Long-Term Debt .....	.150
	I. Deferred Credits .....	.160
	J. Income Taxes .....	.170
	K. Commitments and Contingencies .....	.180
	L. Capital Accounts .....	.190
	M. Income and Expenses .....	.200
	N. Other .....	.210

9220	Partner's Engagement Review Program for Not-for-Profit Organizations . .	.010-.210
	I. General Audit Procedures . . . . .	.010
	A. General . . . . .	.010
	II. Audits of Governmental Grantees . . . . .	.020
	A. General . . . . .	.020
	III. Working Paper Areas . . . . .	.030-.150
	A. Cash . . . . .	.030
	B. Receivables . . . . .	.040
	C. Inventories . . . . .	.050
	D. Investments . . . . .	.060
	E. Prepaid Expenses, Intangible Assets, Deferred Charges, Etc. . . . .	.070
	F. Collections of Works of Art and Similar Items . . . . .	.080
	G. Property and Equipment . . . . .	.090
	H. Liabilities . . . . .	.100
	I. Deferred Revenue . . . . .	.110
	J. Commitments and Contingencies . . . . .	.120
	K. Fund Balance . . . . .	.130
	L. Revenues, Expenses, Support, and Capital Additions . . . . .	.140
	M. Other . . . . .	.150
	IV. Functional Areas . . . . .	.160-.210
	A. Independence . . . . .	.160
	B. Assigning Personnel to Engagements . . . . .	.170
	C. Consultation . . . . .	.180
	D. Supervision . . . . .	.190
	E. Advancement . . . . .	.200
	F. Acceptance and Continuance of Clients . . . . .	.210
9230	Partner's Engagement Review Program for Local Governmental Units . . . .	.010-.200
	I. General Audit Procedures . . . . .	.010
	A. General . . . . .	.010
	II. Compliance With the Requirements of the Single Audit Act of 1984 . . . . .	.020
	A. The Single Audit Act . . . . .	.020
	III. Working Paper Areas . . . . .	.030-.140
	A. Cash . . . . .	.030
	B. Receivables . . . . .	.040
	C. Inventories . . . . .	.050
	D. Investments . . . . .	.060
	E. Prepaid Expenses, Intangible Assets, Deferred Charges, Etc. . . . .	.070
	F. Fixed Assets . . . . .	.080
	G. Liabilities . . . . .	.090
	H. Deferred Revenue . . . . .	.100
	I. Commitments and Contingencies . . . . .	.110
	J. Fund Equity . . . . .	.120
	K. Revenues and Expenditures/Expenses . . . . .	.130
	L. Other . . . . .	.140
	IV. Functional Areas . . . . .	.150-.200
	A. Independence . . . . .	.150
	B. Assigning Personnel to Engagements . . . . .	.160
	C. Consultation . . . . .	.170
	D. Supervision . . . . .	.180
	E. Advancement . . . . .	.190
	F. Acceptance and Continuance of Clients . . . . .	.200
9500	Report Processing . . . . .	.01-.21
	Drafting the Report . . . . .	.01-.04
	Uniformity . . . . .	.03

<i>Section</i>	<i>Paragraph</i>
9500 Report Processing—continued	
Draft of Report .....	.04
Report Production .....	.05-.13
Report Guide Sheet .....	.12
Report Production Control .....	.13
Signing Reports .....	.14-.17
Delivery of Completed Work .....	.18-.21

---

[The next page is 9101.]



# AAM Section 9100

## *Supervision and Review Procedures*

### Introduction

.01 Some of the material presented in this chapter has been taken from the AICPA MAP Handbook.<sup>1</sup> It is presented as an aid to interested parties. The number and complexity of the forms used will vary from firm to firm, engagement to engagement. Their use should be based on the needs of the client, the needs of the firm and the complexity of the engagement.

.02 The various exhibits are presented for guidance only. They are not intended to be a definitive statement of what is required for each engagement, since specific engagements might require a greater or lesser degree of documentation.

### Importance of the Supervision and Review

.03 The supervision and review of work are requirements far more vital and demanding than a mere obligation to perform an agreed assignment satisfactorily. These higher requirements stem directly from the fact that CPAs are engaged by clients to perform personal services of a professional character. The accountant must be sure that the service rendered is performed according to the explicit standards of the profession. Performance of various phases of an engagement may be delegated to subordinates, but responsibility for competence cannot be. When tasks are delegated, comprehensive internal supervision and review are essential.

.04 It is obvious that there is a need to review the work on the engagement, since responsibility for its performance rests upon the individual practitioner or the accounting firm issuing the report. The reviewer should check that the performance of duties delegated to subordinates has been accurate and thorough, that the engagement has been completed in accord with the terms governing it, and that significant accounting and auditing questions raised during the audit have been properly resolved.

.05 A review also serves to guard against errors of principle, judgment, and mathematics. Accountants are subject to the ever-present chance of error; guarding against it must always be uppermost in their minds. This gives added importance to the use of certain formal and standard review procedures. See AAM section 9210 for an illustrative partner's engagement review program.

### Authoritative Literature

.06 In the most general sense, Rule 201(c) (ET section 201.01(c)) of the AICPA Code of Professional Conduct (which applies to all major areas of accounting practice) requires engagements to be adequately planned and supervised. In the case of audits, the following Statements on Auditing Standards (SAS) provide specific guidance on supervising and reviewing audit engagements:

- a. SAS No. 22, *Planning and Supervision* (AU section 311), establishes broad requirements for review of the work of assistants.
- b. SAS No. 41, *Working Papers* (AU section 339), establishes requirements for documenting the supervision of work performed.
- c. SAS No. 47, *Audit Risk and Materiality in Conducting an Audit* (AU section 312), establishes requirements on the evaluation of audit findings, including the analysis and aggregation of errors.

---

<sup>1</sup> *Management of an Accounting Practice Handbook* (AICPA, New York), 1978.



- d. SAS No. 53, *The Auditor's Responsibility to Detect and Report Errors and Irregularities* (AU section 316), requires the auditor to assess the risk that errors and irregularities may cause the financial statements to contain a material misstatement. Based on that assessment, the auditor should design the audit to provide reasonable assurance of detecting errors and irregularities that are material to the financial statements. The auditor's responsibility for detecting misstatements resulting from illegal acts, as defined in SAS No. 54, *Illegal Acts By Clients* (AU section 317), has a direct and material effect on the determination of financial statement amounts, the same as that for other errors and irregularities.
- e. SAS No. 55, *Consideration of the Internal Control Structure in a Financial Statement Audit* (AU section 319), requires the auditor to obtain a sufficient understanding of each of the three elements of the internal control structure to plan the audit by performing procedures to understand the design of policies and procedures relevant to audit planning and whether they have been placed into operation.
- f. SAS No. 56, *Analytical Procedures* (AU section 329), provides guidance on the use of analytical procedures and requires their use in both the planning and review of audits.
- g. SAS No. 57, *Auditing Accounting Estimates* (AU section 342), requires the auditor to evaluate the reasonableness of accounting estimates made by management in the context of the financial statements taken as a whole. When planning and performing procedures to evaluate accounting estimates, the auditor should consider, with an attitude of professional skepticism, both subjective and objective factors on which estimates are based.
- h. SAS No. 59, *The Auditor's Consideration of an Entity's Ability to Continue as a Going Concern* (AU section 341), requires the auditor to evaluate whether there is substantial doubt about an entity's ability to continue as a going concern for a reasonable period of time, not to exceed one year beyond the date of the financial statements being audited.
- i. SAS No. 60, *Communication of Internal Control Structure Related Matters Noted in an Audit* (AU section 325), requires the auditor to report significant deficiencies in the control environment, accounting system, and control procedures to management and the boards of directors or audit committee.

.07 In addition, the Quality Control Standard No. 1, *System of Quality Control for a CPA Firm* (QC section 10), provides that a CPA firm shall have a system of quality control. One of the elements of a quality control system discussed in this standard is supervision. Supervision as an element of quality control is defined as policies and procedures for the conduct and supervision of work to provide that the firm's work meets its standard of quality.

## Review Organization

.08 With respect to review responsibilities, practices are not uniform. Some firms have one partner review all reports issued from the office. In such cases, this partner rarely participates in the field work. Other firms hold each partner responsible for certain engagements and this responsibility, depending upon the size of the firm, can range from field supervision to reviewing and signing the reports.

.09 Some firms can justify a separate review department. While others cannot afford this functional division of duties, neither can they afford to omit any of the review procedures, including some form of final reading of reports before they are typed.

## Firm Policy and Procedures Regarding Supervision and Review

.10 The foundation of good supervision is firm policies and procedures on the conduct and supervision of work. Some examples of such policies are:

1. Provide procedures for planning engagements.
2. Provide procedures for maintaining the quality of work performed.

3. Provide procedures for reviewing engagement workpapers and reports.

.11 Audit planning is discussed in AAM section 3000, *Engagement Planning and Administration*.

.12 Procedures for maintaining the firm's standards of quality work performed may include:

1. Provide adequate supervision at all organizational levels and provide reporting that monitors the extent of supervision.
2. Provide on an ongoing basis reports that highlight audit time budget deviations with explanations and comments on whether the assessment of the control structure needs to be reevaluated.
3. Develop guidelines on the form and content of working papers.
4. Maintain an attitude of professional skepticism when faced with conditions, circumstances or results of analytical procedures that differ from the auditor's expectation.
5. Utilize standardized forms, checklists, and questionnaires that can be tailored, as appropriate, to fit unique client circumstances.
6. Provide procedures for resolving differences of professional judgment.

.13 Procedures for reviewing engagement working papers and reports may include:

1. Develop guidelines for performing and documenting working paper review. Guidelines to be considered could be that:
  - a. Reviewers have appropriate competence and responsibility.
  - b. Work is complete and in conformance with firm policy.
  - c. Reviews are documented in a uniform manner:
    1. Reviewer must initial key workpapers.
    2. A reviewer's questionnaire must be completed.
    3. A reviewer's memorandum must be completed.
    4. Firm standard review checklists are followed.
2. Develop guidelines for performing and documenting report review. Guidelines to be considered could be those above and:
  - a. Both the evidence of the work performed and conclusions contained in the workpapers support the report.
  - b. The report conforms to professional standards and firm policy (SAS No. 58 [AU section 508]).
  - c. The report is reviewed by someone with no other responsibility for the engagement.

.14 Once firm policies and procedures are in place, including development of appropriate forms and checklists, supervision can be applied more effectively.

## Phases of Supervision and Review

.15 There are different phases in the process of supervision and review. The first phase is the supervision and review of the fieldwork. Supervision includes:

- a. Instruction and training of audit staff.
- b. Providing the audit staff with an efficient and effective approach to the audit.

- c. Keeping informed of significant problems encountered.
- d. Reviewing the work performed.
- e. Reviewing the time spent compared with budget.
- f. Dealing with professional differences of opinion among firm personnel.

.16 In larger engagements, the audit team is generally structured to allow much of the responsibility for detailed supervision of new assistants to be delegated to more experienced staff with sufficient competence. Larger engagements may require more formal procedures to assure that the engagement partner is kept informed on a timely basis of significant auditing and accounting issues that are encountered. The engagement partner needs to assure that the audit plan remains appropriate in light of identified issues.

.17 Another phase of the review process is the overall review stage at the completion of the audit. This phase assesses the conclusions reached and evaluates the overall financial statement presentation.

### **Supervision and Review of the Fieldwork**

.18 The objectives of this phase of supervision and review are to assure that:

- 1. The audit plan is either being followed or has been appropriately revised.
- 2. The audit evidence is valid, relevant, sufficient, and appropriately documented.
- 3. If conditions, circumstances, or results of analytical procedures differed adversely from the auditor's expectation, the auditor has considered the reasons for such differences. The firm's procedures for reassessing the planned audit scope and reassessing control risk should be followed.
- 4. The audit objectives were attained and conclusions properly formed concerning the validity of the individual assertions tested.
- 5. Results and conclusions were summarized and documented in a manner so the firm can form an opinion on the financial statements and communicate reportable conditions (SAS No. 60 [AU section 325]).

.19 Audit team members should be instructed as to:

- 1. Their responsibilities:
  - a. To perform their work in accordance with professional standards and firm policy.
  - b. To organize their work in an effective and efficient manner.
  - c. To give timely notification to their supervisor of engagement problems both in the results of tests and in difficulties meeting engagement budgets.
  - d. To maintain an attitude of professional skepticism throughout the audit.
- 2. The objectives of the procedures that they are to perform.
- 3. Matters that may affect the nature, extent, and timing of tests that they are to perform:
  - a. Nature of the entity's business.
  - b. Possible accounting and auditing problems.
  - c. Risk that errors and irregularities may cause the financial statements to contain a material misstatement.
  - d. Assessed level of risk.

4. Procedures that allow audit staff members to document their disagreement with a disputed audit conclusion if they believe it necessary, after appropriate consultation, to disassociate themselves from the resolution of the disagreement. (If this occurs, the basis for the final resolution should also be documented.)
- .20 The detailed review of workpapers by an in-charge of an assistant may contain several of these steps:
- a. Briefly review applicable section of last year's working papers.
  - b. Read relevant section of audit program.
  - c. Compare this year's account balances with last year's.
  - d. Scan workpapers and read conclusions.
  - e. Check that each workpaper is properly headed, initialed, and cross-referenced to the working trial balance.
  - f. Assure that amounts agree with the amounts in the working trial balance and have been traced to the general ledger.
  - g. Check the mechanical and arithmetical accuracy of the working paper. Below are some examples:
    1. Cross reference figures appearing in more than one place in the workpapers.
    2. Test important calculations in the working papers, such as:
      - a. Accruals for interest income and expense.
      - b. Accruals and provisions for state and federal income taxes.
      - c. Accruals for pension and profit sharing plans.
      - d. Accrued bonuses.
      - e. Depreciation.
      - f. Inventory price testing.
      - g. Installment sale income.
      - h. Calculations with respect to leases.
      - i. Earnings per share.
      - j. Compliance with loan agreement restrictions.
      - k. Figures included in notes.
  - h. Assure that the workpaper evidences the performance of the procedures required by the audit program.
  - i. Check that all steps in the audit program have been initialed and dated.
  - j. If the auditor has determined that an audit adjustment is or may be an irregularity but has also determined that the effect on the financial statements could not be material, the auditor should:
    1. Determine that the matter has been referred to an appropriate level of management that is at least one level above those involved.
    2. Be satisfied that, in view of the organizational position of the likely perpetrator, the irregularity has no implications for other aspects of the audit or that those implications have been adequately considered.

- k. If the auditor has determined that an audit adjustment is, or may be, an irregularity and has determined that the effect could be material or has been unable to evaluate the potential materiality, the auditor should determine that:
  - 1. The implications for other aspects of the audit have been considered.
  - 2. Discussions with the appropriate level of management as to the matter and the approach to further investigate that the irregularity has been performed.
  - 3. Sufficient competent evidential matter to determine whether, in fact, material irregularities exist and, if so, their effect has been obtained.
  - 4. If appropriate, suggestions that the client consult with legal counsel on matters concerning questions of law have been made.
- l. Determine that there has been an evaluation of the entity's ability to continue as a going concern for a reasonable period of time (SAS No. 59 [AU section 341]).
- m. Ascertain that analytical procedures were performed at both the planning and final review stages of the audit (SAS No. 56 [AU section 342]).
- n. Determine that all accounting estimates that could be material to the financial statements have been developed and that the accounting estimates are reasonable in the context of the financial statements taken as a whole.
- o. Check cross-references to other current and permanent file workpapers.
- p. Assure that you understand the reasons for any variation between time spent and the audit time budget, in particular, any variances that would change the firm's assessed level of risk or assessment of risk of material misstatement in the financial statements.
- q. Assure that all problems and adjustments were properly documented in accordance with firm policy.

## Overall Review Phase

.21 In practice, there are many variations in the overall review phase of the audit. These variations are due to the differences in client size and complexity, the size of the audit team assigned to the audit and their relative qualifications and individual firm requirements.

.22 The timing of the overall review should take place just prior to the conclusion of the fieldwork. This is to enable the reviewer to resolve problems and expand audit procedures which may be necessitated if any problems arise.

.23 In addition to determining that the technical aspects of the audit are properly documented, the overall review should also include the following:

- a. Read the draft financial statements and notes and perform analytical procedures considering:
  - 1. The adequacy of evidence gathered in response to unusual or unexpected balances identified in planning the audit or in the course of the audit.
  - 2. Unusual or unexpected balances, conditions, or relationships that were not previously expected.
- b. Review workpapers where the reviewer is aware of particular concerns for the client.
- c. Review possible journal entry schedule along with possible disposition.
- d. Review consultation forms and in-charge memos.
- e. Resolve concerns of the in-charge accountant.

f. Resolve any professional disagreements among staff relating to the audit.

.24 The reviewer needs to conclude that:

- a. The engagement was performed in accordance with the engagement letter.
  - b. The audit plan was adequate and fully executed.
  - c. All review points have been cleared.
  - d. The engagement has been completed in accordance with generally accepted auditing standards, generally accepted accounting principles, and firm policy including quality control policies and procedures.
  - e. The reviewer agrees with audit conclusions and the resolution of exceptions.
  - f. Resolution of issues were fully documented.
  - g. The various reports were properly prepared and justified by the evidence.
- 

[The next page is 9201.]



# AAM Section 9210

## *Partner's Engagement Review Program*

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
<b>I. Functional Areas</b>			
<b>A. .010 Independence</b>			
1. Was any evidence noted during the audit which may indicate impaired independence (including a lack of objectivity or threatened litigation), and if so, was the matter identified and appropriately resolved?	_____	_____	_____
2. If the firm was not independent, was the lack of independence disclosed in a report limited to a disclaimer of opinion for a public company, or if applicable, to a compilation report for a nonpublic company?	_____	_____	_____
3. Was timely and appropriate assurance of independence of other firms engaged to perform segments of the engagement obtained?	_____	_____	_____
4. For non-SEC clients, were the fees for the prior year's services paid prior to issuance of the report for the current engagement?	_____	_____	_____
5. For SEC clients, if the fees for the prior year's services were not paid prior to the commencement of the current engagement, were the SEC rules for unpaid professional fees adhered to?	_____	_____	_____
<b>B. .020 Assigning Personnel to Engagements</b>			
1. Were scheduling and staffing requirements approved by a partner on a timely basis?	_____	_____	_____
2. Is the level of experience of the personnel assigned and/or supervision appropriate for the auditor's assessment of the level of risk for the engagement?	_____	_____	_____
<b>C. .030 Consultation</b>			
1. When situations arose in the engagement which, because of firm policy, require consultation, was appropriate consultation made and documented?	_____	_____	_____
2. If the engagement records indicated a difference of opinion between engagement personnel and a specialist or other consultant, was the difference resolved in accordance with firm policy and appropriately documented?	_____	_____	_____
3. Were the considerations involved in the resolution of the differences of opinion mentioned in item 2 above appropriately documented?	_____	_____	_____
<b>D. .040 Supervision</b>			
1. Does it appear that audit planning was adequately documented in the working papers, including any changes in the original plan?	_____	_____	_____
2. Were appropriate personnel assigned to the engagement involved in the planning process?	_____	_____	_____
3. Was background information developed or, if information was obtained from prior engagements, was it updated for changed circumstances (e.g., proposed work program, manpower requirements, etc.)?	_____	_____	_____
4. Did the partner (or manager) approve the overall audit plan (including audit program) as the final planning step and convey his approval or modifications to the engagement staff?	_____	_____	_____
5. Does it appear that adequate supervision was provided considering the background and experience of personnel assigned to the engagement?	_____	_____	_____
6. Does it appear that hours charged by the partner and manager were both adequate and appropriately timed to provide for planning and supervision as the job progressed?	_____	_____	_____
7. Were the firm's guidelines complied with regarding the form and content of audit working papers?	_____	_____	_____



	Yes	No	N/A
8. Were all forms, checklists, or questionnaires, if any, required by firm policy for the following areas adequately completed and modified, where appropriate, for the engagement:			
a. Consideration of the internal control structure:			
(1) Manual system?			
(2) EDP system?			
b. Audit work programs?			
c. Financial statement disclosure?			
d. Time budgets and progress reports?			
e. Working papers and financial statement reviews?			
9. If standardized forms, etc., were not used for any of the above areas, is there other adequate substitute documentation?			
10. Was the guidance given by the applicable industry audit and accounting guide considered during the engagement?			
11. Were differences of professional opinion resolved in accordance with firm policy?			
12. Was an appropriate review made of the working papers, by a person whose position in the firm is commensurate with that responsibility, to determine that work performed is complete and conforms to professional standards and firm policy?			
13. Was an appropriate pre-issuance review made of the report on audit engagements where required by firm policy, by a reviewer whose position in the firm is commensurate with that responsibility and who has no other responsibility for the engagement, to determine that the report conforms to professional standards and firm policy?			
14. Does it appear that planning and supervision were in compliance with SAS No. 22 (AU section 311)?			
<b>E. .050 Professional Development</b>			
1. Does it appear that there was adequate on-the-job training (consider such things as pre- and post-audit conferences, tour of client's facilities, monitoring staff progress, etc.)?			
<b>F. .060 Acceptance and Continuance of Clients</b>			
1. Did the firm comply with its guidelines for acceptance and continuance of clients?			
<b>II. General Procedures</b>			
<b>A. .070 General</b>			
1. If required by firm policy, was an appropriate engagement letter issued?			
2. If the firm has succeeded a predecessor auditor, has there been appropriate communication with the predecessor? (SAS No. 7, paragraphs 4—7 [AU section 315.04—.07])			
3. Did the firm obtain an understanding of the internal control structure which consists of the control environment, the accounting system, and control procedures? (SAS No. 55 [AU section 319])			
a. Was the understanding of the internal control structure documented? (SAS No. 55 [AU section 319])			
b. Did the firm assess the control risk? (SAS No. 55 [AU section 319])			
c. If the firm assessed control risk at below maximum level:			
(1) Were specific internal control structure policies and procedures relevant to specific assertions that are likely to prevent or detect material misstatements identified? (SAS No. 55 [AU section 319])			
(2) Were adequate tests of controls to evaluate the effectiveness of such policies and procedures performed? (SAS No. 55 [AU section 319])			

	Yes	No	N/A
d. If the client used EDP in significant accounting applications, did the assessment of risk in the internal control structure include both general and application controls over EDP activities, including those, if any, at a service organization? (SAS Nos. 44 and 55 [AU sections 324 and 319])	_____	_____	_____
e. If the firm relied on the internal control structure at a service organization, was a service organization's auditor's report obtained and appropriately considered? (SAS No. 44 [AU section 324])	_____	_____	_____
4. Was a written audit program prepared? (SAS No. 22 [AU section 311])	_____	_____	_____
a. Was it responsive to the needs of the engagement and was it developed in light of the internal control structure and the inherent risks in the various audit areas? (SAS No. 55 [AU section 319])	_____	_____	_____
b. Were tests considered in light of SAS No. 45 (AU section 334) regarding related party transactions?	_____	_____	_____
5. Have reportable conditions, if any, in the internal control structure been communicated to the audit committee or to individuals with a level of authority and responsibility equivalent to an audit committee in organizations that do not have one? (SAS No. 60 [AU section 325])	_____	_____	_____
6. Were communications of internal control structure related matters issued in accordance with SAS Nos. 30 and 60 (AU sections 642 and 325)?	_____	_____	_____
7. If consideration was given to the work of internal auditors in determining the scope of the audit, was it done in accordance with SAS No. 9 (AU section 322)?	_____	_____	_____
8. If statistical or nonstatistical sampling was used, were the applicable provisions of SAS No. 39 (AU section 350) followed?	_____	_____	_____
9. If used, were scientific audit tools (e.g., computer auditing, statistical sampling, etc.) properly evaluated by persons with training in these areas? (SAS No. 39 [AU section 350])	_____	_____	_____
10. Did the planning and execution of the engagement include consideration of the possibility of errors and irregularities and management's ability to override control procedures? (SAS No. 53 [AU section 316])	_____	_____	_____
11. Were errors, irregularities, or illegal acts, if any, followed up in accordance with SAS Nos. 53 and 54 (AU sections 316 and 317)?	_____	_____	_____
12. Did the audit strategy and expected conduct and scope of the audit reflect the following assessments:			
a. The risk of material misstatement in the financial statements?	_____	_____	_____
b. The risk of management misrepresentation?	_____	_____	_____
13. Was the audit designed to provide reasonable assurance of detecting material misstatements?	_____	_____	_____
14. If it has been determined that an audit adjustment is or may be an irregularity but it has also been determined that the effect on the financial statements could not be material, has the following been performed:			
a. Referral of the matter to an appropriate level of management that is at least one level above those involved?	_____	_____	_____
b. Obtain satisfaction that, in view of the organizational position of the likely perpetrator, the irregularity has no implications for other aspects of the audit or that those implications have been adequately considered?	_____	_____	_____
15. If it has been determined that an audit adjustment is, or may be, an irregularity and has either determined that the effect could be material or has been unable to evaluate the potential materiality, has the following been performed:			
a. Consideration of the implications for other aspects of the audit?	_____	_____	_____
b. Discussions of the matter and the approach to further investigate the irregularity with an appropriate level of management that is at least one level above those involved?	_____	_____	_____
c. Has sufficient competent evidential matter been obtained to determine whether, in fact, material irregularities exist and, if so, their effect?	_____	_____	_____

	Yes	No	N/A
d. If appropriate, suggestions that the client consult with legal counsel on matters concerning questions of law?	_____	_____	_____
16. When it has been concluded that an illegal act has or is likely to have occurred, has the following been considered:			
a. The effect on the financial statements?	_____	_____	_____
b. The implications for other aspects of the audit?	_____	_____	_____
17. Were analytical procedures used at both the planning and final review stages of the audit?	_____	_____	_____
18. If the engagement included the use of the work (domestic or international) of another office, correspondent, or affiliate:			
a. Do the instructions to the other office or firm appear adequate?	_____	_____	_____
b. Does it appear that control exercised over the work of others through supervision and review was adequate?	_____	_____	_____
c. Was there appropriate follow-up of open matters?	_____	_____	_____
d. In those cases where another firm is used, were appropriate inquiries made as to its professional reputation?	_____	_____	_____
19. Has a letter of representation been obtained from management? (SAS No. 19 [AU section 333])	_____	_____	_____
20. Have all procedures called for in audit programs been signed and dated?	_____	_____	_____
21. Have all questions, exceptions, or notes, if any, posed during the audit been followed up and resolved?	_____	_____	_____
22. Does it appear that appropriate consideration was given to all past adjustments?	_____	_____	_____
23. Does the firm's disclosure checklist document that the audit report is properly prepared and that the financial statements are fairly stated?	_____	_____	_____
24. Was the inquiry letter to the client's legal counsel answered, reviewed, and properly resolved?	_____	_____	_____

### III. Working Paper Areas

#### A. .080 Cash

1. Was due consideration given to cash transactions shortly before and shortly after the balance sheet date to determine that transactions were recorded in the proper period?  
\_\_\_\_\_
2. Were bank accounts confirmed at the audit date and were reconciling items existing at the balance sheet date cleared by reference to subsequent statements obtained directly from the bank?  
\_\_\_\_\_
3. Do the working papers indicate that the following were considered:
  - a. Restrictions on cash balances?  
\_\_\_\_\_
  - b. Confirmation of bank credit arrangements such as compensating balances?  
\_\_\_\_\_
  - c. Review of confirmation responses for indication of related party transactions?  
\_\_\_\_\_
4. Based on the assessed level of control risk, do the substantive tests of cash appear adequate?  
\_\_\_\_\_

#### B. .090 Receivables

1. Was a summary prepared (or obtained) properly classifying receivables (i.e., notes and accounts receivable; trade; officers, directors, and employees; parent and subsidiary companies; other related party transactions; etc.)?  
\_\_\_\_\_
2. Were accounts receivable circularized and appropriate follow-up steps taken?  
\_\_\_\_\_
3. If confirmation work was performed prior to year-end, is there evidence that an adequate review was made of transactions from the confirmation date to the balance sheet date?  
\_\_\_\_\_
4. If a significant number and amount of accounts receivable were not circularized, is there evidence that other auditing procedures were performed?  
\_\_\_\_\_
5. Were significant notes receivable confirmed as of the audit date?  
\_\_\_\_\_

	Yes	No	N/A
6. Were the results of confirmation procedures summarized in the working papers?	_____	_____	_____
7. Was collateral (if any) for receivables examined with respect to existence, ownership, and value?	_____	_____	_____
8. Were adequate tests made of discounts and allowances?	_____	_____	_____
9. Was the reasonableness of allowances for doubtful accounts covered in the working papers and collectibility of receivables adequately considered?	_____	_____	_____
10. Is there evidence in the working papers that inquiry was made and consideration given to whether receivables are pledged or factored?	_____	_____	_____
11. Was receivables work correlated with the sales and inventory cut-off examination?	_____	_____	_____
12. Are notes receivable accounted for to reasonably represent the present value of the consideration exchanged and an appropriate interest rate? (APB Opinion No. 21 [AC 169])	_____	_____	_____
13. Based on the assessed level of control risk, do the substantive tests of receivables appear adequate?	_____	_____	_____
<b>C. .100 Inventories</b>			
1. Was an inventory summary prepared (or obtained) showing basis (e.g., "costs," "market," "LIFO," "FIFO," etc.) with respect to the various classifications of inventory (e.g., finished goods, work-in-process, raw materials, etc.)?	_____	_____	_____
2. Where the physical inventory is taken at a date other than the balance sheet date (or where rotating procedures are used), do the working papers indicate that consideration was given to inventory transactions between the inventory date(s) and the balance sheet date?	_____	_____	_____
3. Do the working papers contain evidence that counts were correctly made and recorded (i.e., was control maintained over inventory tags or count sheets) and were test count quantities reconciled with counts reflected in final inventory?	_____	_____	_____
4. Do the working papers indicate that adequate tests were made of:			
a. The clerical accuracy of the compilation of the inventory?	_____	_____	_____
b. Costing methods and substantiation of costs used in pricing all elements (raw materials, work-in-process, finished goods) of the inventory?	_____	_____	_____
5. Do the working papers indicate that a lower of cost or market test was performed (including obsolescence)?	_____	_____	_____
6. If perpetual inventory records are maintained, do the working papers indicate that differences disclosed by the client's physical inventory (or cycle counts) are properly reflected in the accounts?	_____	_____	_____
7. Was an examination of purchase and sales commitments made, including consideration as to any possible adverse effects?	_____	_____	_____
8. Were appropriate inventory cut-off tests performed?	_____	_____	_____
9. Where applicable, were gross profit percentage tests employed to check overall valuation of inventories?	_____	_____	_____
10. Where the physical inventory in the hands of others was not observed, were inventory confirmations received (i.e., inventory in public warehouses, on consignment, etc.)?	_____	_____	_____
11. Do the working papers indicate that steps were performed to determine if any inventory is pledged?	_____	_____	_____
12. Based on the assessed level of control risk, do the substantive tests of inventory appear adequate?	_____	_____	_____
<b>D. .110 Investments</b>			
1. Was a summary schedule prepared (or obtained) and details examined with respect to description, purchase price and data, changes during period, income market value, etc., of investments?	_____	_____	_____
2. Were all securities (including stock certificates of subsidiary companies) either examined or confirmed?	_____	_____	_____

	Yes	No	N/A
3. Was investigation made of carrying value and possible cost impairment of long-term investments?	_____	_____	_____
4. Do the working papers indicate that consideration was given to indications that investments were pledged?	_____	_____	_____
5. For investments accounted for on the equity method, were financial statements and other information reviewed to support the amounts presented?	_____	_____	_____
6. Do the working papers indicate that adequate evidential matter had been accumulated for long-term investments?	_____	_____	_____
7. Based on the assessed level of control risks, do the substantive tests of investments appear adequate?	_____	_____	_____
<b>E. .120 Prepaid Expenses, Intangible Assets, Deferred Charges, Etc.</b>			
1. Were adequate tests made and/or confirmations received for all material:			
a. Prepaid expenses?	_____	_____	_____
b. Intangible assets?	_____	_____	_____
c. Deferred charges?	_____	_____	_____
d. Other?	_____	_____	_____
2. For prepayments, intangibles, and deferred charges, is there adequate support for the deferral and amortization (or lack thereof)?	_____	_____	_____
3. If insurance policies were pledged as collateral or subjected to premium financing, were the related loans properly accounted for?	_____	_____	_____
<b>F. .130 Property, Plant, and Equipment</b>			
1. Was a summary schedule prepared (or obtained) to show beginning balances, changes during the period, and ending balances for:			
a. Property, plant, and equipment?	_____	_____	_____
b. Accumulated depreciation?	_____	_____	_____
2. Do tests appear adequate with respect to:			
a. Additions:			
(1) Examination of supporting documents?	_____	_____	_____
(2) Physical inspection?	_____	_____	_____
b. Retirement, etc. (including examination of miscellaneous income, scrap sales, etc.)?	_____	_____	_____
c. The adequacy of current and accumulated provisions for depreciation and depletion?	_____	_____	_____
d. Compliance with control procedures?	_____	_____	_____
e. Status of idle facilities?	_____	_____	_____
3. Do the working papers indicate the presence of liens on property?	_____	_____	_____
4. Were differences between book and tax depreciation reconciled?	_____	_____	_____
<b>G. .140 Current Liabilities</b>			
1. Were accounts payable adequately tested for propriety?	_____	_____	_____
2. Do the working papers include evidence as to compliance with any loan restrictions?	_____	_____	_____
3. Was an adequate test made of subsequent transactions (i.e., cash disbursements, voucher register entries, vouchers, unpaid invoices, etc.) to determine if any material unrecorded liabilities existed?	_____	_____	_____
4. Was the payable work correlated with the purchase cutoff examination?	_____	_____	_____
5. Was consideration given to costs and expenses that might require accrual (e.g., compensated absences—see FASB Statement No. 43 [AC C44]), and to whether accrued expenses were reasonably stated?	_____	_____	_____
6. Based on the assessed level of control risk, do the substantive tests of liabilities appear adequate?	_____	_____	_____

	Yes	No	N/A
<b>H. .150 Long-Term Debt</b>			
1. Were confirmations received for significant debt obligations, together with verification of interest rates, repayment period, etc.?	_____	_____	_____
2. Is there evidence that covenants to long-term debt obligations are being complied with?	_____	_____	_____
3. Have leases been examined to determine that capital leases have been properly accounted for? (FASB Statement No. 13, paragraphs 6—14 [AC L10.102—.109 and .112])	_____	_____	_____
<b>I. .160 Deferred Credits</b>			
1. Do the working papers indicate that:			
a. The basis of deferring income is reasonable and on a consistent basis from year to year?	_____	_____	_____
b. Deferrals have been established on a reasonable basis?	_____	_____	_____
<b>J. .170 Income Taxes</b>			
1. Were current and deferred tax accrual accounts and related provisions analyzed and reviewed as to adequacy?	_____	_____	_____
<b>K. .180 Commitments and Contingencies</b>			
1. Do the working papers include indication of the following:			
a. Inspection of minutes of meetings of the stockholders, board of directors, and executive and other committees of the board?	_____	_____	_____
b. Inspection of contracts, loan agreements, leases, and correspondence from taxing and other governmental agencies, and similar documents?	_____	_____	_____
c. Accumulation and analysis of confirmation responses from banks and lawyers?	_____	_____	_____
d. Inquiry and discussion with management (including management's written representations concerning liabilities, and litigation, claims, and assessments)?	_____	_____	_____
e. Inspection of other documents for possible guarantees by the client?	_____	_____	_____
2. Is there indication that procedures were performed to uncover the need for recording or disclosure of events subsequent to the date of the financial statements? (SAS No. 1, section 560.10—.12 [AU section 560.10—.12])	_____	_____	_____
<b>L. .190 Capital Accounts</b>			
1. Were changes in capitalization checked to authorizations?	_____	_____	_____
2. Do the working papers indicate that adequate inquiries were made appropriate, as to			
a. Stock options?	_____	_____	_____
b. Warrants?	_____	_____	_____
c. Rights?	_____	_____	_____
d. Redemptions?	_____	_____	_____
e. Conversion Privileges?	_____	_____	_____
<b>M. .200 Income and Expenses</b>			
1. Were tests made of payrolls, including account distribution?	_____	_____	_____
2. With regard to pension and profit sharing plans (including impact of ERISA), do tests made of the expense and liabilities appear adequate?	_____	_____	_____
3. Were revenue and expenses for the period compared with those of the preceding period and reviewed for reasonableness; were significant fluctuations explained?	_____	_____	_____
4. Was adequate consideration given to review of the client's revenue recognition policy and unusual sales transactions?	_____	_____	_____
5. Has adequate consideration been given to loss contingencies in accordance with FASB Statement No. 5 (AC C59)?	_____	_____	_____
6. Based upon the evaluation of internal control do the substantive tests (review, analysis, and casting) of income and expense appear adequate?	_____	_____	_____

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
<b>N. .210 Other</b>			
1. Have leases been examined to determine that capital sales, and direct financing leases have been properly accounted for? (FASB Statement No. 13, paragraphs 6—14, 17—18, 20—22, and 24—27 [AC L10.102—.109, .112—.114, .116—.118, and .120—.123]; FASB Statement No. 22, paragraphs 12—15 [AC L10.109 and .113]; FASB Statement No. 23, paragraphs 7—9 [AC L10.104, .106, and .113—.114]; FASB Statement No. 27, paragraphs 6—8 [AC L10.102 and .113]; FASB Statement No. 28, paragraphs 2—3 [AC L10.128—.129]; FASB Statement No. 29, paragraphs 10—12 [AC L10.404 and .417]; FASB Statement No. 98, paragraph 22 [AC L10.102—.104, .113—.115, .121—.122, .414, and .418])	_____	_____	_____
2. Were procedures applied to supplementary information in accordance with SAS No. 52 (AU section 558), as applicable?	_____	_____	_____
3. If the work of a specialist was used, was the effect of the specialist's work on the auditor's report considered in accordance with SAS No. 11, paragraphs 9—12 (AU section 336.09—.12)?	_____	_____	_____
4. Were specific procedures applied for determining the existence of related parties and examining identified related party transactions? (SAS No. 45 [AU section 334])	_____	_____	_____
5. Was the guidance in SAS No. 47 (AU section 312) regarding audit risk and materiality considered during the planning and performance of the engagement?	_____	_____	_____

This audit engagement has been completed in accordance with professional standards and firm policy.

Partner \_\_\_\_\_ Date \_\_\_\_\_

[The next page is 9271.]

# AAM Section 9220

## *Partner's Engagement Review Program for Not-for-Profit Organizations*

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
<b>I. General Audit Procedures</b>			
<b>A. .010 General</b>			
1. In planning the audit engagement, were the following matters properly considered:			
a. Matters affecting the environment in which the entity operates, such as accounting practices, economic conditions, government regulations, contractual obligations and technological changes? (SAS No. 22 [AU section 311])	_____	_____	_____
b. Matters affecting the entity's operations, such as legal organization and types of services? (SAS No. 22 [AU section 311])	_____	_____	_____
c. Preliminary judgment about materiality levels for audit purposes? (SAS No. 47 [AU section 312])	_____	_____	_____
d. Consideration of the internal control structure? (SAS No. 47 [AU section 312])	_____	_____	_____
e. Conditions that may require extension or modification of audit tests, such as the possibility of material errors or irregularities and management's ability to override controls? (SAS No. 53 [AU section 316])	_____	_____	_____
f. Other audit risks?	_____	_____	_____
2. If the firm succeeded a predecessor accountant, did the firm:			
a. Communicate with the predecessor accountant to ascertain whether there were disagreements between the predecessor accountant and the entity's management on accounting or auditing matters and consider the implications of such matters in accepting the client?	_____	_____	_____
b. Make other inquiries of the predecessor accountant on significant matters?	_____	_____	_____
c. Satisfy itself on the fair presentation of opening balances, such as by reviewing the predecessor accountant's working papers?	_____	_____	_____
3. Did the firm obtain an understanding of the internal control structure which consists of the control environment, the accounting system, and control procedures? (SAS No. 55 [AU section 319])	_____	_____	_____
a. Was the understanding of the internal control structure documented? (SAS No. 55 [AU section 319])	_____	_____	_____
b. Did the firm assess the control risk? (SAS No. 55 [AU section 319])	_____	_____	_____
c. If the firm assessed control risk at below maximum level:			
(1) Were specific internal control structure policies and procedures relevant to specific assertions that are likely to prevent or detect material misstatements identified? (SAS No. 55 [AU section 319])	_____	_____	_____
(2) Were adequate tests of controls to evaluate the effectiveness of such policies and procedures performed? (SAS No. 55 [AU section 319])	_____	_____	_____
d. If the client used computer processing in significant accounting applications, did the assessment of risk in the internal control structure include an evaluation of the extent, as well as the complexity of that processing, including those, if any, of an outside service center? (SAS Nos. 44, 48, and 55 [AU sections 324, 311, and 319])	_____	_____	_____
e. If the firm relied on the internal control structure at a service organization, was a service auditor's report obtained and appropriately considered? (SAS No. 44 [AU section 324])	_____	_____	_____



	Yes	No	N/A
4. Was audit planning appropriately documented?	_____	_____	_____
5. Was a written audit program prepared? (SAS No. 22 [AU section 311])	_____	_____	_____
a. Was it responsive to the needs of the engagement identified during the planning process and was it developed in light of the internal control structure? (SAS No. 55 [AU section 319])	_____	_____	_____
b. Was consideration given to applicable assertions in developing audit objectives and in designing substantive tests? (SAS No. 31, paragraphs 9 through 13 [AU section 326.09—.13])	_____	_____	_____
c. Were tests considered in light of SAS No. 45 (AU section 334) regarding related party transactions?	_____	_____	_____
d. If conditions changed during the course of the audit, was the audit program modified as appropriate in the circumstances?	_____	_____	_____
6. If statistical or nonstatistical sampling was used in test controls of the internal control structure (SAS No. 39, paragraphs 31 through 42 [AU section 350.31—.42]):			
a. In planning the sampling application, was appropriate consideration given to the specific objective of the test, tolerable rate, allowable risk of overreliance, and likely rate of deviations?	_____	_____	_____
b. Was the sample selected in such a way that it could be expected to be representative of the population?	_____	_____	_____
c. Were the results of the sample evaluated as to their effect on the nature, timing, and extent of planned substantive procedures?	_____	_____	_____
d. In evaluating the sample, was appropriate consideration given to items for which the planned test or appropriate alternative procedure could not be performed, for example, because the documentation was missing?	_____	_____	_____
e. Was the documentation of the foregoing considerations in accordance with firm policy?	_____	_____	_____
7. If statistical or nonstatistical sampling was used for substantive tests of details (SAS No. 39, paragraphs 15 through 30 [AU section 350.15—.30]):			
a. In planning the sampling application, was appropriate consideration given to the specific audit objective, tolerable error, acceptable level of risk of incorrect acceptance, and characteristics of the population?	_____	_____	_____
b. Was the sample selected in such a way that it could be expected to be representative of the population?	_____	_____	_____
c. Were the error results of the sample projected to the items from which the sample was selected?	_____	_____	_____
d. In evaluating the sample, was appropriate consideration given to items for which the planned substantive tests or appropriate alternate procedures could not be performed?	_____	_____	_____
e. In the evaluation of whether the financial statements may be materially misstated, was appropriate consideration given, in the aggregate, to projected error results from all audit sampling applications and to all known errors from nonsampling applications?	_____	_____	_____
f. Was the documentation of the foregoing considerations in accordance with firm policy?	_____	_____	_____
8. Were the guidelines of SAS No. 56, <i>Analytical Procedures</i> (AU section 329), utilized in the performance of analytical procedures for:			
a. The planning of the audit?	_____	_____	_____
b. Use as a substantive test?	_____	_____	_____
c. Overall reviews of the audit?	_____	_____	_____
9. Did the firm obtain timely and appropriate responses from the auditee's attorney concerning litigation, claims, and assessments? (SAS No. 12 [AU section 337])	_____	_____	_____
10. Have all procedures called for in the audit program been signed?	_____	_____	_____

	Yes	No	N/A
11. Have all questions, exceptions, or notes, if any, posed during the audit been followed up and resolved, including consideration of the views obtained from responsible officials of the organization, program, activity, or function audited concerning the auditor's findings, conclusions, and recommendations?	_____	_____	_____
12. Did the firm obtain a timely and appropriate letter of representation from management? (SAS No. 19 [AU section 333])	_____	_____	_____
13. Does it appear that appropriate consideration was given to all past adjustments and to the risk that the current period's financial statements are materially misstated when prior-period likely errors are considered with likely errors arising in the current period? (SAS No. 47 [AU section 312])	_____	_____	_____
14. Were errors, irregularities, or illegal acts, if any, followed up in accordance with SAS Nos. 53 and 54 (AU sections 316 and 317)?	_____	_____	_____
15. Have reportable conditions, if any, in the internal control structure been communicated to the audit committee or to individuals with a level of authority and responsibility equivalent to an audit committee in organizations that do not have one? (SAS No. 60 [AU section 325])	_____	_____	_____
16. Was the disclosure checklist properly completed?	_____	_____	_____

## II. Audits of Governmental Grantees

Note: These questions are derived from the U.S. General Accounting Office's (GAO) *Standards for Audit of Governmental Organizations, Programs, Activities, and Functions* ("Yellow Book") and the Office of Management and Budget, Circular A-110 (*Uniform Administrative Requirements for Grants and Other Agreements with Institutions of Higher Education, Hospitals, and Other Nonprofit Organizations*).

### A. .020 General

1. If the audit was required to be conducted in accordance with the GAO's Standards for Audit, do the auditor's report(s) include references to GAO's Standards for Audit, and appropriately cover:			
a. The financial statements, including, where presented, the combining and individual fund financial statements?	_____	_____	_____
b. Tests of controls based solely on the evaluation of the effectiveness of the controls made as part of the audit of the financial statements?	_____	_____	_____
c. Compliance with finance-related legal and contractual provisions, including a summary of questioned costs and/or instances of noncompliance?	_____	_____	_____
d. When appropriate, did the auditors issue a report on fraud, abuse, or an illegal act, or indications of such acts to the entity arranging the audit?	_____	_____	_____
2. If required, did the auditor's report on internal control identify:			
a. The entity's significant internal controls structure and those controls designed to provide reasonable assurance that federal programs are being managed in compliance with laws and regulations?	_____	_____	_____
b. The controls that were evaluated?	_____	_____	_____
c. The controls that were not evaluated?	_____	_____	_____
d. The level of control risk identified as a result of the evaluation?	_____	_____	_____
3. If required, did the auditor's report on compliance include:			
a. A statement of positive assurance with respect to those items tested for compliance with laws and regulations pertaining to financial reports?	_____	_____	_____
b. Negative assurance on those items not tested?	_____	_____	_____
c. A summary of material instances of noncompliance?	_____	_____	_____
4. If required by contractual obligations, were findings presented in accordance with the guidance in the GAO's standards regarding reporting on economy and efficiency audits and program results audits?	_____	_____	_____
5. Was interfund activity properly reviewed and were differences between total interfund receivables and total interfund payables investigated and resolved?	_____	_____	_____

	Yes	No	N/A
6. If applicable, were adequate tests of controls with applicable laws and regulations made?	_____	_____	_____
7. If evidence exists of situations or transactions that could be indicative of fraud, waste, abuse or illegal expenditures and acts, did the auditor:			
a. Either obtain management's approval to extend audit steps and procedures to identify the effect on the entity's financial statements or consider issuing a disclaimer of opinion because of a scope limitation?	_____	_____	_____
b. Give prompt notice to the appropriate management officials of the entity arranging the audit?	_____	_____	_____
8. Were all reportable conditions in the internal control structure and all identified instances of noncompliance with applicable laws and regulations:			
a. Adequately evaluated and documented?	_____	_____	_____
b. Appropriately reported in accordance with applicable standards? (SAS No. 60 [AU section 325; GAO's Standards for Audit, pp. 28-29; OMB A-110, Attachment F])	_____	_____	_____
9. Do the working papers indicate that consideration was given to prior audits of government financial assistance programs that disclosed questionable or disallowed costs, or instance of noncompliance?	_____	_____	_____

### III. Working Paper Areas

#### A. .030 Cash

1. Was due consideration given to cash transactions shortly before and shortly after the balance sheet date to determine that transactions were recorded in the proper period?	_____	_____	_____
2. Were bank accounts confirmed and were reconciling items existing at the balance sheet date cleared by reference to subsequent statements obtained directly from the bank or obtained from the client and appropriately tested?	_____	_____	_____
3. Do the working papers indicate that the following were considered:			
a. Restrictions on cash balances?	_____	_____	_____
b. Confirmation of bank credit arrangements such as compensating balances?	_____	_____	_____
c. Review of confirmation responses for indication of related party transactions?	_____	_____	_____
d. Confirmation of liabilities and contingent liabilities to banks?	_____	_____	_____
e. Authorization for interfund cash transactions?	_____	_____	_____
f. Determination that all cash accounts have been identified and appropriately recorded?	_____	_____	_____
4. Based on the assessed level of control risk, do the substantive tests of cash appear adequate?	_____	_____	_____

#### B. .040 Receivables

1. Were accounts receivable circularized and appropriate follow-up steps taken, including second requests and alternate procedures?	_____	_____	_____
2. If confirmation work was performed prior to year-end, is there evidence that there was an adequate review of transactions from the confirmation date to the balance sheet date?	_____	_____	_____
3. If a significant number and amount of accounts receivable were not circularized, is there evidence that other auditing procedures were performed?	_____	_____	_____
4. Were significant notes receivable confirmed as of the balance sheet date?	_____	_____	_____
5. Were the results of confirmation procedures summarized in the working papers?	_____	_____	_____
6. Was collateral (if any) for receivables examined with respect to existence, ownership and value?	_____	_____	_____
7. Were procedures performed to provide evidence that pledge receivables are properly recorded in the appropriate funds?	_____	_____	_____
8. Was the reasonableness of allowances for doubtful accounts covered in the working papers and collectibility of receivables adequately considered?	_____	_____	_____

	Yes	No	N/A
9. Is there evidence in the working papers that inquiry was made and consideration given to whether receivables are pledged, assigned or otherwise encumbered?	_____	_____	_____
10. Was receivable work coordinated with tests of support and revenue, including cutoff tests?	_____	_____	_____
11. Were procedures performed to obtain evidence of whether notes receivable are accounted for to reasonably represent the present value of the consideration exchanged and an appropriate interest rate?	_____	_____	_____
12. Based on the assessed level of control risks, do the substantive tests of receivables appear adequate?	_____	_____	_____
<b>C. .050 Inventories</b>			
1. Was an inventory summary showing basis prepared or obtained?	_____	_____	_____
2. Do the working papers indicate that a lower of cost or market test (including consideration of obsolete slow-moving inventory) was performed?	_____	_____	_____
3. Do the working papers indicate that there were adequate tests of:			
a. Physical observation, if material?	_____	_____	_____
b. The clerical accuracy of the compilation of the inventory?	_____	_____	_____
c. Costing methods and substantiation of costs used in pricing all inventory elements?	_____	_____	_____
4. Based on the assessed level of control risk, do the substantive tests of inventory appear adequate?	_____	_____	_____
<b>D. .060 Investments</b>			
1. Was a summary schedule prepared (or obtained) and details examined with respect to description, purchase price and date, changes during the period, income, market value, etc., of investments?	_____	_____	_____
2. Were all securities either examined or confirmed?	_____	_____	_____
3. Do the working papers reflect consideration of changes in the carrying value of both investments and marketable securities and appropriateness of unrealized gains and losses that were recognized?	_____	_____	_____
4. Were realized gains and losses on dispositions of securities properly computed?	_____	_____	_____
5. Were income and realized and unrealized gains and losses from investments examined for proper allocation to the individual funds?	_____	_____	_____
6. Do the working papers indicate that consideration was given to indications that investments were pledged, restricted, or had limitations on immediate use?	_____	_____	_____
7. Do the working papers indicate that risk of loss on repurchase agreements was properly considered?	_____	_____	_____
8. Do the working papers indicate that repurchase security transactions were reviewed for consistency with the disclosures of the terms or circumstances of the transactions?	_____	_____	_____
<b>E. .070 Prepaid Expenses, Intangible Assets, Deferred Charges, Etc.</b>			
1. Were adequate tests made and/or confirmations received for all material:			
a. Prepaid expenses?	_____	_____	_____
b. Intangible assets?	_____	_____	_____
c. Deferred charges?	_____	_____	_____
d. Other?	_____	_____	_____
2. Is there adequate support for the deferral and amortization (or lack thereof) of these types of assets?	_____	_____	_____
3. If insurance policies were pledged as collateral or subjected to premium financing, were the related loans properly accounted for?	_____	_____	_____
<b>F. .080 Collections of Works of Art and Similar Items</b>			

	Yes	No	N/A
1. If the collection is considered inexhaustible (i.e., exhibits owned by museums, art galleries, botanical gardens, etc.) and has been capitalized, do the working papers indicate that the auditor tested the reasonableness of the collection's carrying value?	_____	_____	_____
2. If the collection is considered exhaustible and has been capitalized, do the working papers indicate that the auditor tested the reasonableness of the collection's carrying value and related amortization?	_____	_____	_____
3. Are the tests adequate with respect to acquisitions and deaccessions?	_____	_____	_____
4. If the collection is capitalized:			
a. Were physical inventories observed at all locations where relatively large amounts are located?	_____	_____	_____
b. Do the working papers contain evidence that counts were correctly made and recorded (i.e., was control over inventory tags or count sheets maintained) and were test count quantities reconciled with the quantities reflected in the final inventory?	_____	_____	_____
5. If the collection is considered inexhaustible and has not been capitalized, do the working papers indicate that the auditor:			
a. Evaluated the internal controls over the collection?	_____	_____	_____
b. Observed a physical inventory at all locations where large amounts are located?	_____	_____	_____
<b>G. .090 Property and Equipment</b>			
1. Was a summary schedule by source prepared (or obtained) to show beginning balances, changes during the period and ending balances for:			
a. Property and equipment?	_____	_____	_____
b. Accumulated depreciation (where applicable)?	_____	_____	_____
2. Do tests appear adequate with respect to:			
a. Additions by the examination of supporting documents and/or physical inspection?	_____	_____	_____
b. Retirements, etc. (including examination of miscellaneous income, scrap sales, and restrictions on disposals by donors, grantors, or governmental agencies)?	_____	_____	_____
c. The adequacy of current and accumulated provisions for depreciation (where applicable)?	_____	_____	_____
d. Valuation of assets not previously capitalized?	_____	_____	_____
3. Do the working papers indicate that the auditor considered the possibility that property was subject to liens or restrictions by donors, grantors, or governmental agencies?	_____	_____	_____
4. Was a review made to determine that capital expenditures are classified in the proper fund accounts?	_____	_____	_____
5. Based on the assessed level of control risk, do the substantive tests of property, plant, and equipment appear adequate?	_____	_____	_____
<b>H. .100 Liabilities</b>			
1. Were accounts payable adequately tested for propriety?	_____	_____	_____
2. Were liabilities properly classified as current or long-term and in the proper fund?	_____	_____	_____
3. Was an adequate test of subsequent transactions (i.e., cash disbursements, voucher register entries, vouchers, unpaid invoices, etc.) made to determine if any unrecorded liabilities existed that were material individually or in the aggregate in relation to the financial statement?	_____	_____	_____
4. Was consideration given to expenditures and expenses that might require accrual (e.g., pensions or compensated absences), and to whether accrued expenses were reasonably stated?	_____	_____	_____
5. Were procedures performed to determine whether tax deferred annuity plans are appropriately calculated to conform with GAAP and IRS regulations?	_____	_____	_____

	Yes	No	N/A
6. Were confirmations for significant notes and bonds payable, together with verification of interest rates, repayment period, etc., received?	_____	_____	_____
7. Were audit procedures performed to obtain evidence of whether debt obligations were accounted for to represent reasonably the present value of the consideration exchanged and an appropriate interest rate?	_____	_____	_____
8. Is there evidence that covenants in debt obligations are being complied with?	_____	_____	_____
9. Was consideration given to any liabilities (including the effect of any timing differences) resulting from the Federal excise tax on investment income and any Federal and State taxes on unrelated business income?	_____	_____	_____
10. Do the tests of interfund borrowings appear adequate with respect to:			
a. Legal restrictions, if any, on such borrowings?	_____	_____	_____
b. Authorization?	_____	_____	_____
c. Classification?	_____	_____	_____
d. Collectibility of amounts due from other funds?	_____	_____	_____
e. Appropriateness of interest accruals and payments?	_____	_____	_____
11. Based on the assessed level of control risk, do the substantive tests of liabilities appear adequate?	_____	_____	_____
<b>I. .110 Deferred Revenue</b>			
1. Do the working papers indicate that consideration was given to whether the basis of deferring revenue is reasonable and consistent with the donors' or grantors' restrictions?	_____	_____	_____
2. Was consideration given to matching requirements, if any?	_____	_____	_____
3. Do the working papers indicate that consideration was given to the appropriateness of the amounts of restricted gifts, grants, bequests, donations, or other income recognized as current revenue or support?	_____	_____	_____
<b>J. .120 Commitments and Contingencies</b>			
1. Do the working papers include indication of the following:			
a. Inspection of minutes of meetings of the governing board and other appropriate committees of the board?	_____	_____	_____
b. Inspection of contracts, loan agreements, leases, and correspondence from donors, grantors, and governmental agencies, and similar documents?	_____	_____	_____
c. Accumulation and analysis of confirmation responses from banks and lawyers?	_____	_____	_____
d. Inquiry and discussion with management (including management's written representations concerning liabilities and litigation, claims, and assessments)?	_____	_____	_____
2. Is there indication that procedures were performed to uncover the need for recording or disclosing events subsequent to the date of the financial statements? (SAS No. 1, section 560.10—.12 [AU section 560.10—.12])	_____	_____	_____
3. Did the auditor consider evidence of the entity's activities (such as lobbying) which might cause the entity to lose its tax exempt status or be subject to penalties or taxes?	_____	_____	_____
4. If the entity is a private foundation, as defined by IRC section 509, did the auditor determine whether the entity complied with IRS regulations concerning required distribution of income and prohibited activities?	_____	_____	_____
<b>K. .130 Fund Balance</b>			
1. Where appropriate, were authorizations of changes in reserves and designated balances examined?	_____	_____	_____
2. Do the working papers indicate that there were adequate inquiries, where appropriate, as to proper classification, description and disclosure of components of the fund balance?	_____	_____	_____
3. Do the working papers indicate that fund transfers were properly approved and recorded?	_____	_____	_____

	Yes	No	N/A
4. If an endowment fund is maintained, do the working papers indicate that fund income is distributed to unrestricted and restricted funds in accordance with donors' stipulations?	_____	_____	_____
<b>L. .149 Revenues, Expenses, Support, and Capital Additions</b>			
1. Were revenues and expenses for the period compared with those of the preceding period and reviewed for reasonableness and were significant fluctuations explained?	_____	_____	_____
2. Was adequate consideration given to:			
a. The entity's revenue recognition policy?	_____	_____	_____
b. Income recognition on transactions where the earnings process is not complete?	_____	_____	_____
3. Do the working papers indicate that consideration was given to the valuation and classification of revenue derived from service fees, such as subscription and membership income, and sales of publications and other items?	_____	_____	_____
4. If the entity is reimbursed by a third party for costs incurred in connection with providing services to others:			
a. Were pertinent sections of significant third party contracts reviewed to determine the basis for reimbursement?	_____	_____	_____
b. Were cost reimbursement reports and the underlying support reviewed?	_____	_____	_____
c. Were appropriate allocations made of indirect costs among the entity's programs?	_____	_____	_____
5. Do the working papers indicate that the auditor considered actual receipt of, propriety of, and any restrictions placed on amounts received during the current period from:			
a. Cash contributions?	_____	_____	_____
b. Donated services?	_____	_____	_____
c. Gifts of securities, materials, facilities, and other nonmonetary items?	_____	_____	_____
d. Future interests and interest free loans?	_____	_____	_____
6. If expenses are classified by function, did the auditor adequately test the classifications and allocations?	_____	_____	_____
7. If grants are awarded to other organizations, did the auditor review:			
a. The classification of the grants?	_____	_____	_____
b. The effects of the grantees' compliance or noncompliance with performance requirements?	_____	_____	_____
8. Were tests of payrolls, including account distribution, made?	_____	_____	_____
9. With regard to pension plans, do the tests made of the expense and liabilities appear adequate?	_____	_____	_____
10. Has adequate consideration been given to loss contingencies in accordance with SFAS No. 5 (AC C59)?	_____	_____	_____
11. Based upon the assessed level of control risk, did the substantive tests (review, analysis, and testing) of revenues and expenditures/expense appear adequate?	_____	_____	_____
<b>M. .150 Other</b>			
1. Have leases been examined to determine that capital, sales, and direct financing leases have been properly accounted for?	_____	_____	_____
2. Were procedures applied to additional information in accordance with SAS No. 29 (AU section 551), as applicable?	_____	_____	_____
3. If the work of a specialist was used, did the auditor apply the guidance in SAS No. 11 (AU section 336)?	_____	_____	_____
4. Were specific procedures for determining the existence of related parties and examining identified related party transactions applied? (SAS No. 45 [AU section 334])	_____	_____	_____

	Yes	No	N/A
5. If the entity is affiliated or otherwise financially related to other entities, did the auditor consider the need for combined financial statements or disclosure of the relationship?	_____	_____	_____

**IV. Functional Areas****A. .160 Independence**

1. If any evidence was noted which may indicate a lack of independence (including a lack of objectivity), was the matter identified and appropriately resolved and its impact appropriately considered?	_____	_____	_____
2. Was timely and appropriate assurance of independence of other firms engaged to audit segments or component units of the engagement obtained?	_____	_____	_____
3. Were the fees for the prior year's services paid prior to issuance of the report for the current engagement?	_____	_____	_____

**B. .170 Assigning Personnel to Engagements**

1. Were scheduling and staffing requirements identified on a timely basis and approved by appropriate personnel?	_____	_____	_____
2. Is the level of experience of the personnel assigned and/or supervision appropriate for the auditor's assessment of the level of risk for the engagement?	_____	_____	_____

**C. .180 Consultation**

1. Was there appropriate consultation and documentation thereof:			
a. In situations specified by firm policy?	_____	_____	_____
b. Where the complexity or unusual nature of the issue warranted it?	_____	_____	_____
2. Were the firm's conclusions consistent with professional standards?	_____	_____	_____
3. If the engagement records indicate a difference of opinion between engagement personnel and a specialist or other consultant, was the difference resolved in accordance with firm policy and appropriately documented?	_____	_____	_____
4. Were the considerations involved in the resolution of the differences of opinion mentioned in item 3 above appropriately documented?	_____	_____	_____

**D. .190 Supervision**

1. Were appropriate personnel assigned to the engagement involved in the planning process?	_____	_____	_____
2. Does it appear that audit planning was adequately documented in the working papers, including any changes in the original plan?	_____	_____	_____
3. Did the partner (or manager) approve the overall audit plan (including audit program) as the final planning step and convey his approval or modifications to the engagement staff?	_____	_____	_____
4. Does it appear that hours charged by the partner, manager, and, where applicable, by the concurring reviewer were adequate and appropriately timed to provide for planning and supervision as the job progressed?	_____	_____	_____
5. Were all forms, checklists, or questionnaires, if any, required by firm policy for the following areas adequately completed and modified, where appropriate, for the engagement:			
a. Planning checklist?	_____	_____	_____
b. Review of internal control?	_____	_____	_____
(1) Manual system?	_____	_____	_____
(2) EDP system?	_____	_____	_____
c. Audit work programs?	_____	_____	_____
d. Financial statement disclosures?	_____	_____	_____
e. Working papers and financial statement reviews?	_____	_____	_____
6. If standardized forms, etc., were not used for any of the above areas, is there other adequate substitute documentation?	_____	_____	_____



	Yes	No	N/A
7. Were the firm's guidelines for the form and content of audit working papers complied with?	_____	_____	_____
8. Were differences of professional opinion resolved in accordance with firm policy?	_____	_____	_____
9. Does it appear that adequate supervision was provided considering the background and experience of personnel assigned to the engagement?	_____	_____	_____
10. If used, were scientific audit tools (e.g., computer auditing, statistical sampling, etc.) properly evaluated by persons with training in these areas? (SAS No. 48 [AU section 311.10])	_____	_____	_____
11. Was an appropriate review made of the working papers, report, and financial statements by a person whose position in the firm is commensurate with that responsibility, to determine that work performed is complete and conforms to professional standards and firm policy?	_____	_____	_____
12. Was an appropriate pre-issuance review made in accordance with firm policy?	_____	_____	_____
13. Does it appear that planning and supervision were in compliance with SAS Nos. 22 and 47 (AU sections 311 and 312) and interpretations of SAS No. 22 (AU section 9311)?	_____	_____	_____
<b>E. .200 Advancement</b>			
1. If required by firm policy, have the staff on this engagement been appropriately evaluated based on the work performed?	_____	_____	_____
<b>F. .210 Acceptance and Continuance of Clients</b>			
1. Does it appear that the firm's guidelines for acceptance and continuance of clients were complied with?	_____	_____	_____

This audit engagement has been completed in accordance with professional standards and firm policy.

Partner \_\_\_\_\_ Date \_\_\_\_\_

[The next page is 9351.]

# AAM Section 9230

## *Partner's Engagement Review Program for Local Governmental Units*

	<u>Yes</u>	<u>No</u>	<u>N/A</u>
<b>I. General Audit Procedures</b>			
<b>A. .010 General</b>			
1. In planning the audit engagement, did the firm properly consider:			
a. Matters affecting the government, such as specialized accounting practices, economic conditions, Federal and State laws and regulations, and technological changes? (SAS No. 22 [AU section 311])	_____	_____	_____
b. Definition of the reporting entity indicating the related organizations, functions, and activities which are either included or excluded from the financial statements in accordance with GASB Cod. Sec. 2100?	_____	_____	_____
c. Preliminary judgment about materiality levels for audit purposes? (SAS No. 47 [AU section 312])	_____	_____	_____
d. Anticipated reliance on internal control structure? (SAS No. 47 [AU section 312])	_____	_____	_____
e. Conditions that may require extension or modification of audit tests, such as the possibility of material errors or irregularities and management's ability to override controls? (SAS No. 53 [AU section 316])	_____	_____	_____
f. Factors affecting the continued functioning of the government, such as legal limitations on revenue, expenditures, or debt service?	_____	_____	_____
g. Other audit risks?	_____	_____	_____
2. If the firm succeeded a predecessor accountant, did it:			
a. Communicate with the predecessor accountant to ascertain whether there were disagreements between the predecessor accountant and the entity's management on accounting or auditing matters and consider the implications of such matters in accepting the client?	_____	_____	_____
b. Make other inquiries of the predecessor accountant on significant matters?	_____	_____	_____
c. Satisfy itself on the fair presentation of opening balances, such as by reviewing the predecessor accountant's working papers?	_____	_____	_____
3. If consideration was given to the work of internal auditors in determining the scope of the audit, was it done in accordance with SAS No. 9 (AU section 322)?	_____	_____	_____
4. If the engagement included work performed by joint auditors or by another office correspondent, or affiliate of the firm:			
a. Do the instructions to the other office or firm appear adequate?	_____	_____	_____
b. Does it appear that control exercised over the work of others through supervision and review was adequate?	_____	_____	_____
c. Was there appropriate follow-up of open matters?	_____	_____	_____
d. In those cases where another firm is used, were appropriate inquiries made as to its independence and professional reputation?	_____	_____	_____
e. For a jointly signed audit report, are there indications that the auditor has conducted sufficient audit procedures to warrant signing the report in an individual capacity?	_____	_____	_____
5. Did the firm obtain an understanding of the internal control structure which consists of the control environment, the accounting system, and control procedures? (SAS No. 55 [AU section 319])	_____	_____	_____

	Yes	No	N/A
a. Was the understanding of the internal control structure documented? (SAS No. 55 [AU section 319])	_____	_____	_____
b. Did the firm assess the control risk? (SAS No. 55 [AU section 319])	_____	_____	_____
c. If the firm assessed control risk at below maximum level:			
(1) Were specific internal control structure policies and procedures relevant to specific assertions that are likely to prevent or detect material misstatements identified? (SAS No. 55 [AU section 319])	_____	_____	_____
(2) Were adequate tests of controls to evaluate the effectiveness of such policies and procedures performed? (SAS No. 55 [AU section 319])	_____	_____	_____
d. If the client used computer processing in significant accounting applications, did the assessment of risk in the internal control structure include an evaluation of the extent, as well as the complexity of that processing, including those, if any, of an outside service center? (SAS Nos. 44, 48, and 55 [AU sections 324, 311, and 319])	_____	_____	_____
e. If the firm relied on the internal control at a service organization, was a service auditor's report obtained and appropriately considered? (SAS No. 44 [AU section 324])	_____	_____	_____
6. Was a written audit program prepared? (SAS No. 22 [AU section 311])	_____	_____	_____
a. Was it responsive to the needs of the engagement identified during the planning process and in light of the internal control structure? (SAS No. 55 [AU section 319])	_____	_____	_____
b. Was consideration given to applicable assertions in developing audit objectives and in designing substantive tests? (SAS No. 31, paragraphs 9 through 13 [AU section 326.09—.13])	_____	_____	_____
c. If conditions changed during the course of the audit, was the audit program modified as appropriate in the circumstances?	_____	_____	_____
d. Have all audit program procedures been signed?	_____	_____	_____
7. If statistical or nonstatistical sampling was used in performing tests of controls to evaluate the effectiveness of the internal control structure (SAS No. 55 [AU section 319]):			
a. In planning the sampling application, was appropriate consideration given to the specific objective of the tests of controls, tolerable rate, allowable risk of overreliance, and likely rate of deviations?	_____	_____	_____
b. Was the sample selected in such a way that it could be expected to be representative of the population?	_____	_____	_____
c. Were the results of the sample evaluated as to their effect on the nature, timing, and extent of planned substantive procedures?	_____	_____	_____
d. In evaluating the sample, was appropriate consideration given to items for which the planned tests of controls or appropriate alternative procedures could not be performed, for example, because the documentation was missing?	_____	_____	_____
e. Was the documentation of the foregoing considerations in accordance with firm policy?	_____	_____	_____
8. If statistical or nonstatistical sampling was used for substantive tests and tests of applicable laws and regulations, if appropriate (SAS No. 39, paragraphs 15 through 30 [AU section 350.15—.30]):			
a. In planning the sampling application was appropriate consideration given to the specific audit objective, tolerable error, acceptable level of risk of incorrect acceptance, and characteristics of the population?	_____	_____	_____
b. Was the sample selected in such a way that it could be expected to be representative of the population?	_____	_____	_____
c. Were the error results of the sample projected to the items from which the sample was selected?	_____	_____	_____
d. In evaluating the sample, was appropriate consideration given to items for which the planned substantive tests or appropriate alternate procedures could not be performed?	_____	_____	_____

	Yes	No	N/A
e. In the evaluation of whether the financial statements may be materially misstated, was appropriate consideration given, in the aggregate, to projected error results from all audit sampling applications and to all known errors from nonsampling applications?	_____	_____	_____
f. Was the documentation of the foregoing considerations in accordance with firm policy?	_____	_____	_____
9. Were the guidelines of SAS No. 56, <i>Analytical Procedures</i> (AU section 329), utilized in the performance of analytical procedures for:			
a. The planning of the audit?	_____	_____	_____
b. Use as a substantive test?	_____	_____	_____
c. Overall reviews of the audit?	_____	_____	_____
10. Did the firm obtain a timely and appropriate letter of representation from management? (SAS No. 19 [AU section 333])	_____	_____	_____
11. Did the firm obtain timely and appropriate responses from the entity's attorney concerning litigation, claims, and assessments? (SAS No. 12 [AU section 337])	_____	_____	_____
12. Have all questions, exceptions, or notes, if any, posed during the audit been resolved, including consideration of views obtained from responsible officials of the entity concerning the auditor's findings, conclusions, and recommendations?	_____	_____	_____
13. Does it appear that appropriate consideration was given to all past adjustments and to the risk that the current period's financial statements are materially misstated when prior period likely errors are considered with likely errors arising in the current period? (SAS No. 47 [AU section 312])	_____	_____	_____
14. If applicable, were adequate tests of controls with applicable laws and regulations made?	_____	_____	_____
15. If evidence exists of situations or transactions that could be indicative of fraud, waste, abuse, and illegal expenditures and acts, did the auditor:			
a. Either obtain management's approval to extend audit steps and procedures to identify the effect on the entity's financial statements or consider issuing a disclaimer of opinion because of a scope limitation?	_____	_____	_____
b. Give prompt notice to the appropriate management officials of the recipient above the level of involvement?	_____	_____	_____
16. Were all reportable conditions in the internal control structure, all identified instances of noncompliance with applicable laws and regulations, and all illegal acts:			
a. Adequately evaluated and documented?	_____	_____	_____
b. Appropriately reported in accordance with applicable standards? (SAS No. 60 [AU section 325]; GAO's Standards for Audit, pp. 28-29; OMB Circular A-128, paragraph 13)	_____	_____	_____
17. Was disclosure checklist properly completed?	_____	_____	_____

## II. Compliance With the Requirements of the Single Audit Act of 1984

### A. .020 The Single Audit Act

- |  |       |       |       |
|--|-------|-------|-------|
| 1. If required or deemed necessary, is there any indication that the firm discussed and agreed on the scope of the engagement with the auditee?  | _____ | _____ | _____ |
| 2. Did the firm, by reviewing contract files and receipts and disbursements, obtain reasonable assurance that the auditee appropriately identified all federal financial assistance and included that assistance within the audit scope? | _____ | _____ | _____ |
| 3. If required, does the schedule of federal financial assistance program expenditures present the following:  |       |       |       |
| a. Identification of each program as indicated in the <i>Catalog of Federal Domestic Assistance</i> (CFDA)?  | _____ | _____ | _____ |
| b. Other federal assistance from programs not included in the CFDA?  | _____ | _____ | _____ |

	Yes	No	N/A
c. Total expenditures for each federal financial assistance program by grantor, department, or agency?	_____	_____	_____
d. Total federal financial assistance?	_____	_____	_____
e. Other information, either required by federal program managers or otherwise deemed appropriate?	_____	_____	_____
4. Was consideration given to the accounting and auditing guidance issued by the Office of Management and Budget, including Circulars A-128 ( <i>Audits of State and Local Governments</i> ), A-87 ( <i>Cost Principles Applicable to Grants and Contracts</i> ), and A-102 ( <i>Uniform Requirements for Assistance to State and Local Governments</i> )?	_____	_____	_____
5. Did the firm obtain an understanding of the internal control structure policies and procedures, as it relates to:			
a. Administering major federal financial assistance programs, comparable to that which the auditor would perform if he assessed control risk at below the maximum level? (SAS No. 55 [AU section 319])	_____	_____	_____
b. Administering non-major programs to the same extent as in question 5a above, so that over at least 50% of total federal assistance program expenditures are reviewed?	_____	_____	_____
c. Other non-major federal financial assistance programs?	_____	_____	_____
6. For those programs where the control risk is assessed at the maximum level, is the firm's understanding of the internal control structure as well as the conclusion of the control risk documented? (SAS No. 55 [AU section 319])	_____	_____	_____
7. For categories of controls for which the control risk is below the maximum level:			
a. Do the working papers document the firm's understanding of the internal control structure?	_____	_____	_____
b. Were tests of controls performed for the internal control structure?	_____	_____	_____
c. Was the nature and extent of testing sufficient to enable the firm to determine if the control procedures were being applied as described?	_____	_____	_____
d. Did the auditor examine the recipient's control structure for ensuring subrecipients' compliance and obtaining and acting on subrecipients' audit reports?	_____	_____	_____
e. Do the working papers adequately document the work performed and the conclusions reached? (GAO, p. 26; SAS No. 41, paragraph 5 [AU section 339.05])	_____	_____	_____
8. Were all reportable conditions in the internal control structure disclosed in the auditor's reports?	_____	_____	_____
9. In determining whether the entity has complied with applicable laws and regulations that may have a material effect on each major federal financial assistance program, did the auditor:			
a. Consult appropriate sources, such as the Compliance Supplement for Single Audits of State and Local Governments, statutes, regulations, and agreements covering individual programs, in order to identify the compliance requirements that apply to each major program and to determine which requirements to test?	_____	_____	_____
b. Select a representative number of charges from each major program?	_____	_____	_____
c. Perform tests to determine whether:			
(1) The amounts reported as expenditures were allowable under federal regulations and contracts?	_____	_____	_____
(2) Only eligible persons or organizations received services or benefits?	_____	_____	_____
(3) Matching requirements were met?	_____	_____	_____
(4) Federal financial reports and claims for advances and reimbursements were supported by the records supporting the financial statements?	_____	_____	_____
(5) The entity complied with each of the general requirements contained in the compliance supplement concerning:			

	Yes	No	N/A
(a) Political activity?	_____	_____	_____
(b) Civil rights?	_____	_____	_____
(c) Davis-Bacon Act?	_____	_____	_____
(d) Cash management?	_____	_____	_____
(e) Relocation of assistance and real property acquisition?	_____	_____	_____
(f) Federal financial reports?	_____	_____	_____
d. Consider projected error results from all audit sampling applications and all known errors from non-sampling applications?	_____	_____	_____
e. Consider whether his tests of compliance with the program's requirements appear adequate to support his report(s) on compliance?	_____	_____	_____
10. Where transactions related to non-major federal financial assistance programs have been selected during other audit procedures, have they been appropriately tested for compliance with applicable laws and regulations in connection with the audit of financial statements and evaluations of internal control structure?	_____	_____	_____
11. If warranted, did the firm communicate with the cognizant agency to avoid or minimize any disagreements or problems?	_____	_____	_____
12. Did the firm submit the report(s) to the organization audited and to those requiring or arranging for the audit within the required time?	_____	_____	_____
13. Has the firm established policies or procedures for complying with the additional requirements concerning:			
a. Retaining working papers and reports for a minimum of three years from the date of the audit report, unless the auditor is notified in writing by the cognizant agency to extend the retention period?	_____	_____	_____
b. Making the working papers available upon request to the cognizant agency or its designee or the GAO at the completion of the audit?	_____	_____	_____

### III. Working Paper Areas

#### A. .030 Cash

1. Was due consideration given to cash transactions shortly before and shortly after the balance sheet date to determine that transactions were recorded in the proper period? \_\_\_\_\_
2. Were bank accounts confirmed and were reconciling items existing at the balance sheet date cleared by reference to subsequent statements? \_\_\_\_\_
3. Do the working papers indicate that the following were considered:
  - a. Restrictions on cash balances? \_\_\_\_\_
  - b. Confirmation of bank credit arrangements such as compensating balances? \_\_\_\_\_
  - c. Review of confirmation responses for indication of related party transactions? \_\_\_\_\_
  - d. Confirmation of liabilities and contingent liabilities to banks? \_\_\_\_\_
  - e. Approval of interfund cash transactions? \_\_\_\_\_
  - f. Verification of collateral required of depository institutions for public funds? \_\_\_\_\_
  - g. Compliance with the laws and regulations governing the deposit of public funds? \_\_\_\_\_
  - h. Determination that all cash accounts have been identified and appropriately recorded? \_\_\_\_\_
  - i. Review of repurchase security transactions for consistency with the disclosures on the terms or circumstances of the transactions? \_\_\_\_\_
4. Based on the assessed level of risk, do the substantive tests of cash appear adequate? \_\_\_\_\_

#### B. .040 Receivables

1. Was a summary properly classifying receivables prepared or obtained (i.e., notes and accounts receivable, tax revenues, interfund transactions, and other related party receivables, etc.)? \_\_\_\_\_

	Yes	No	N/A
2. Were accounts receivable circularized and appropriate follow-up steps taken, including second requests and alternate procedures?	_____	_____	_____
3. If confirmation work was performed prior to year-end, is there evidence that there was an adequate review of transactions from the confirmation date to the balance sheet date?	_____	_____	_____
4. If a significant number and amount of accounts receivable were not circularized, is there evidence that other auditing procedures were performed?	_____	_____	_____
5. Were significant notes receivable confirmed as of the balance sheet date?	_____	_____	_____
6. Were the results of confirmation procedures summarized in the working papers?	_____	_____	_____
7. Was collateral (if any) for receivables examined with respect to existence, ownership and value?	_____	_____	_____
8. Were procedures performed to provide evidence that taxes receivable and the related revenues have been recorded in the correct period in accordance with GASB Cod. Sec. P70?	_____	_____	_____
9. Were adequate tests of discounts and allowances made?	_____	_____	_____
10. Was the reasonableness of allowances for doubtful accounts covered in the working papers and collectibility for receivables, including interfund receivables, adequately considered?	_____	_____	_____
11. Is there evidence in the working papers that inquiry was made and consideration given to whether receivables are pledged, assigned or otherwise encumbered?	_____	_____	_____
12. Was receivable work coordinated with tests of revenues, including cutoff tests?	_____	_____	_____
13. Were procedures performed to obtain evidence that the carrying value of notes receivable reasonably represent the present value of the consideration exchanged and an appropriate interest rate? (APB Opinion No. 21 [AC I69])	_____	_____	_____
14. Based on the assessed level of control risk, do the substantive tests of receivables appear adequate?	_____	_____	_____
<b>C. .050 Inventories</b>			
1. Was an inventory summary showing basis prepared or obtained?	_____	_____	_____
2. Do the working papers indicate that a lower of cost or market test (including consideration of obsolete or slow-moving inventory) was performed?	_____	_____	_____
3. Do the working papers indicate that there were adequate tests of:			
a. Physical observation, if material?	_____	_____	_____
b. The clerical accuracy of the compilation of the inventory?	_____	_____	_____
c. Costing methods and substantiation of costs used in pricing all inventory elements?	_____	_____	_____
4. Based on the assessed level of control risk, do the substantive tests of inventory appear adequate?	_____	_____	_____
<b>D. .060 Investments</b>			
1. Was a summary schedule prepared (or obtained) and details examined with respect to description, purchase price and date, changes during the period, income, market value, etc., of investments?	_____	_____	_____
2. Were all securities either examined or confirmed?	_____	_____	_____
3. Were gains and losses on disposition of securities properly computed?	_____	_____	_____
4. Do the working papers reflect consideration of the appropriateness of carrying values of marketable securities and their classification?	_____	_____	_____
5. Was investigation of carrying value and possible cost impairment of long-term investments made?	_____	_____	_____
6. Do the working papers reflect consideration that investments were pledged, restricted, or had limitations on immediate use?	_____	_____	_____
7. For joint venture investments (accounted for on the equity or other method), were financial statements and other information reviewed to support the amounts presented and the related footnote disclosures?	_____	_____	_____

	Yes	No	N/A
8. Do the working papers indicate that adequate evidential matter had been accumulated for long-term investments?	_____	_____	_____
9. Was a review made to determine whether the investments are of the types authorized by law or comply with the applicable statutes and investment policy?	_____	_____	_____
10. Were income, gains and losses from investments examined for proper allocation to the individual funds?	_____	_____	_____
11. For repurchase and reverse repurchase agreements, were appropriate audit procedures performed (e.g., confirmation, inspection of collateral, etc.)?	_____	_____	_____
<b>E. .070 Prepaid Expenses, Intangible Assets, Deferred Charges, Etc.</b>			
1. Were adequate tests made and/or confirmations received for all material:			
a. Prepaid expenses?	_____	_____	_____
b. Intangible assets?	_____	_____	_____
c. Deferred charges?	_____	_____	_____
d. Other?	_____	_____	_____
2. Is there adequate support for the deferral and amortization (or lack thereof) of these types of assets?	_____	_____	_____
<b>F. .080 Fixed Assets</b>			
1. Was a summary schedule by source prepared (or obtained) to show beginning balances, changes during the period and ending balances for:			
a. Property, plant, and equipment?	_____	_____	_____
b. Accumulated depreciation (where applicable)?	_____	_____	_____
2. Do tests appear adequate with respect to:	_____	_____	_____
a. Additions by the examination of supporting documents and/or physical inspection?	_____	_____	_____
b. Retirements, etc. (including examination of miscellaneous income, scrap sales, etc.)?	_____	_____	_____
c. The adequacy of current and accumulated provisions for depreciation (where applicable)?	_____	_____	_____
d. Status of idle facilities?	_____	_____	_____
3. Do working papers indicate that the auditor considered the possibility that property was subject to liens?	_____	_____	_____
4. Was a review made to determine that capital expenditures are classified in the proper fund accounts and made in accordance with budgetary requirements?	_____	_____	_____
5. Based on the assessed level of control risk do the substantive tests of property, plant, and equipment appear adequate?	_____	_____	_____
<b>G. .090 Liabilities</b>			
1. Were accounts and warrants payable adequately tested for propriety?	_____	_____	_____
2. Were liabilities properly classified as current or long-term?	_____	_____	_____
3. Was an adequate test of subsequent transactions (i.e., cash disbursements, voucher register) made to determine if any unrecorded liabilities existed that were material individually or in the aggregate in relation to the financial statements?	_____	_____	_____
4. Was the payable work coordinated with the testing of the purchase cutoff?	_____	_____	_____
5. Was consideration given to expenditures and expenses that might require accrual (e.g., pensions, compensated absences—see GASB Cod. Sec. 1600), and to whether accrued expenses were reasonably stated?	_____	_____	_____
6. Were procedures performed to determine whether deferred compensation plans are appropriately disclosed? (GASB Statement No. 2)	_____	_____	_____
7. Do the working papers include evidence as to compliance with any loan restrictions?	_____	_____	_____
8. Were confirmations for significant notes and bonds payable, together with verification of interest rates, repayment period, etc., received?	_____	_____	_____



	Yes	No	N/A
9. Were audit procedures performed to obtain evidence that the carrying value of debt obligations reasonably represent the present value of the consideration exchanged and an appropriate interest rate?	_____	_____	_____
10. Is there evidence that loan restrictions and covenants to debt obligations are being complied with?	_____	_____	_____
11. Was an examination made to determine that:			
a. New debt issues are properly issued as required by the state constitution or state/local statute and are recorded in the correct fund and/or account group?	_____	_____	_____
b. Debt restrictions, guarantees, and other debt commitments are properly disclosed?	_____	_____	_____
12. Do the tests of interfund borrowings appear adequate with respect to:			
a. Legal restrictions, if any, on such borrowings?	_____	_____	_____
b. Authorization?	_____	_____	_____
c. Classification?	_____	_____	_____
d. Appropriateness of interest accruals and payments?	_____	_____	_____
13. Based on the assessed level of control risk, do the substantive tests of liabilities appear adequate?	_____	_____	_____
<b>H. .100 Deferred Revenue</b>			
1. Do the working papers reflect consideration of whether the basis of deferring revenue is reasonable and consistent with restrictions imposed by the grantor or by the special assessment?	_____	_____	_____
2. Was consideration given to matching requirements, if any?	_____	_____	_____
<b>I. .110 Commitments and Contingencies</b>			
1. Do the working papers include indication of the following:			
a. Inspection of minutes of meetings of the governmental body and key committees thereof, provisions of the governmental unit's charter, and applicable statutes and changes therein?	_____	_____	_____
b. Inspection of contracts, loan agreements, leases, correspondence from taxing and other governmental agencies, and similar documents?	_____	_____	_____
c. Accumulation and analysis of confirmation responses from banks and lawyers?	_____	_____	_____
d. Inquiry and discussion with management (including management's written representations concerning liabilities and litigation, claims and assessments)?	_____	_____	_____
e. Consideration of prior audits of federal financial assistance programs that disclosed questionable or disallowed costs, or instances of noncompliance?	_____	_____	_____
f. Inspection of long-term contracts with non-governmental entities, such as construction contractors?	_____	_____	_____
2. Is there indication that procedures were performed to uncover the need for recording or disclosing events subsequent to the date of the financial statements? (SAS No. 1, section 560.10—.12 [AU section 560.10—.12])	_____	_____	_____
3. Have all material contingencies been properly considered, documented, and reported (SFAS No. 5 [AC C59]; GASB Cod. Sec. C50)?	_____	_____	_____
<b>J. .120 Fund Equity</b>			
1. Where appropriate, were authorizations of changes in reserves and designated balances examined?	_____	_____	_____
2. Do the working papers indicate that there were appropriate inquiries, where appropriate, as to proper classification, description, and disclosures of components of the fund equity?	_____	_____	_____
3. Do the working papers indicate that fund transfers were properly approved and recorded?	_____	_____	_____
<b>K. .130 Revenues and Expenditures/Expenses</b>			
1. Were revenues and expenditures and/or expenses for the period compared with those of the preceding period and reviewed for reasonableness and were significant fluctuations explained?	_____	_____	_____

	Yes	No	N/A
2. Was adequate consideration given to:			
a. The entity's revenue recognition policy?			
b. Income recognition on transactions where the earnings process was not complete?			
3. Do the working papers indicate that revenues and interfund transactions have been recognized in the accounting period in which they became available and measurable under the applicable basis of accounting?			
4. Do the working papers indicate that the auditor considered the effect of program income on federal grants and any related activities?			
5. Has it been determined that:			
a. Expenditures are in accordance with the approved budget as to amounts and purpose?			
b. Encumbrances are properly identified, supported, and recorded?			
c. Indirect cost allocations are in accordance with OMB Circular A-87?			
6. Were tests of payrolls, including account distribution, made?			
7. With regard to pension plans, do the tests made of the expense and liabilities appear adequate?			
8. If the entity is reimbursed by a third party for costs incurred in connection with providing services to others:			
a. Were pertinent sections of significant third party contracts reviewed to determine the basis for reimbursement?			
b. Were cost reimbursement reports and the underlying support reviewed?			
c. Were appropriate allocations made of indirect costs among the entity's programs?			
d. Was the effect of audits, either required or performed by third party grantors, considered?			
9. If grants are awarded to other organizations, did the auditor review:			
a. The classification of the grants?			
b. The effects of the grantees' compliance or noncompliance with performance requirements?			
10. Has adequate consideration been given to loss contingencies in accordance with SFAS No. 5 (AC C59)?			
11. Based upon the assessed level of control risk, did the substantive tests (review, analysis, and testing) of revenues and expenditures/expense appear adequate?			
L. .140 Other			
1. Have leases been examined to determine that capital, sales, and direct financing leases have been properly accounted for? (GASB Cod. Sec. L20)			
2. Were procedures applied to supplementary information in accordance with SAS No. 29 (AU section 551)?			
3. If the work of a specialist was used, did the auditor apply the guidance in SAS No. 11 (AU section 336)?			
4. Were specific procedures applied for determining the existence of related parties and examining identified related party transactions? (SAS No. 45 [AU section 334])			

#### IV. Functional Areas

##### A. .150 Independence

- |   |  |  |  |
|---|--|--|--|
| 1. If any evidence was noted during the review which may indicate a lack of independence (including a lack of objectivity), was the matter identified and appropriately resolved by the firm and its impact appropriately considered? |  |  |  |
| 2. Was timely and appropriate assurance of independence of other firms engaged to audit segments or component units of the engagement obtained?   |  |  |  |

	Yes	No	N/A
3. Were the fees for the prior year's services paid prior to issuance of the report for the current engagement?	_____	_____	_____
<b>B. .160 Assigning Personnel to Engagements</b>			
1. Were scheduling and staffing requirements identified on a timely basis and approved by appropriate personnel?	_____	_____	_____
2. Is the level of experience of the personnel assigned and/or supervision appropriate for the auditor's assessment of the level of risk for the engagement?	_____	_____	_____
<b>C. .170 Consultation</b>			
1. Was there appropriate consultation and documentation thereof:			
a. In situations specified by firm policy?	_____	_____	_____
b. Where the complexity or unusual nature of the issue warranted it?	_____	_____	_____
2. Were the firm's conclusions consistent with professional standards?	_____	_____	_____
3. If the engagement records indicated a difference of opinion between engagement personnel and a specialist or other consultant, was the difference resolved in accordance with firm policy and appropriately documented?	_____	_____	_____
4. Were the considerations involved in the resolution of the differences of opinion mentioned in item 3 above appropriately documented?	_____	_____	_____
<b>D. .180 Supervision</b>			
1. Were appropriate personnel assigned to the engagement involved in the planning process?	_____	_____	_____
2. Does it appear that audit planning was adequately documented in the working papers, including any changes in the original plan?	_____	_____	_____
3. Did the partner (or manager) approve the overall audit plan (including audit program) as the final planning step and convey his approval or modifications to the engagement staff?	_____	_____	_____
4. Does it appear that hours charged by the partner, manager, and, where applicable, by the concurring reviewer, were adequate and appropriately timed to provide for planning and supervision as the job progressed?	_____	_____	_____
5. Were all forms, checklists, or questionnaires, if any, required by firm policy for the following areas adequately completed and modified, where appropriate, for the engagement:	_____	_____	_____
a. Planning checklist?	_____	_____	_____
b. Consideration of the internal control structure?			
(1) Manual system?	_____	_____	_____
(2) EDP system?	_____	_____	_____
c. Audit work programs?	_____	_____	_____
d. Financial statement disclosures?	_____	_____	_____
e. Working papers and financial statement reviews?	_____	_____	_____
6. If standardized forms, etc., were not used for any of the above areas, is there other adequate substitute documentation?	_____	_____	_____
7. Were the firm's guidelines for the form and content of audit working papers complied with?	_____	_____	_____
8. Were differences of professional opinion resolved in accordance with firm policy?	_____	_____	_____
9. Does it appear that adequate supervision was provided considering the background and experience of personnel assigned to the engagement?	_____	_____	_____
10. If used, were scientific audit tools (e.g., computer auditing, statistical sampling, etc.) properly evaluated by persons with training in these areas? (SAS No. 48 [AU section 311])	_____	_____	_____

	Yes	No	N/A
11. Was an appropriate review made of the working papers, report, and financial statements by a person whose position in the firm is commensurate with that responsibility, to determine that work performed is complete and conforms to professional standards and firm policy?	_____	_____	_____
12. Was an appropriate pre-issuance review made in accordance with firm policy?	_____	_____	_____
13. Does it appear that planning and supervision were in compliance with SAS Nos. 22 and 47 (AU section 311 and 312) and interpretations of SAS No. 22 (AU section 9311)?	_____	_____	_____
<b>E. .190 Advancement</b>			
1. If required by firm policy, have the staff on this engagement been appropriately evaluated based on the work performed?	_____	_____	_____
<b>F. .200 Acceptance and Continuance of Clients</b>			
1. Does it appear that the firm's guidelines for acceptance and continuance of clients were complied with?	_____	_____	_____

This audit engagement has been completed in accordance with professional standards and firm policy.

Partner \_\_\_\_\_ Date \_\_\_\_\_

[The next page is 9501.]



# AAM Section 9500

## *Report Processing*

### Drafting the Report

.01 The only tangible evidence a client receives of the CPA's work is the written report. Since weeks or months of effort may have been spent in its preparation (for which the client pays a substantial fee), it is only prudent that every effort be made to insure the superior quality of its presentation.

.02 While most financial statements do not offer the opportunity for creativity in writing style, the effectiveness of many special reports is influenced by the quality of the writing. Clarity and propriety in an accountant's report are not achieved through use of long words, technical language or complicated reasoning, but through simple language used to present important thoughts, supported by documentation. Proper grammar and sentence structure improve readability. Effective use of forceful words with smooth transitions between sentences will help hold the reader's interest. If the subject matter is of deep concern to management and if management has respect for the auditor's opinion, it is likely that the recommendations will be followed by action, especially if the author communicates effectively. This is particularly true where the report is to be the basis for a management decision.

### Uniformity

.03 Strict uniformity may stifle creative thinking, but a consistent format adds quality to the written report.

1. The client's name should appear at the top of every statement with identical spelling and punctuation. The certificate of incorporation should be inspected to determine the exact name of the corporation. Accuracy in seemingly small matters, such as whether "the" is part of the name, the word "Company" or "Incorporated" is abbreviated or spelled out, or commas are part of the name, is important to the accountant's reputation.
2. Descriptive phraseology should be uniform. If the phrase "cost of goods sold" is used in the income statement, then a schedule of these costs should show "cost of goods sold," not "cost of sales."
3. The manner in which the date or period covered is indicated should also be uniform. If the income statement is headed "for the year ended December 31, 19\_\_," then all supporting schedules should be headed that way, rather than "for the year 19\_\_."
4. Schedule and statement headings should conform to a pattern. For example, if "schedule of cost of goods sold" is used, then all other schedules should begin with "schedule of."
5. Statement and schedule headings should be the same in the letter, table of contents, index, and other references.
6. Each page should be well balanced, paragraphs should break in the right places, tables should be centered and not broken except when a table is longer than a page, page numbers should be in the same place on each sheet, type should be clean and alignment even, and there should be no "strikeovers" or visible erasures.

7. As part of firm policy, the following should be standardized:

Title	Captions
Indexing	Spacing
Salutation	Indentation
Page Numbering	Paragraphing
Closing and Signing	Capitalization
Dating	Underscoring
Whole Dollar Reporting	Punctuation
Headings	Dollar Signs
Double or Single Spacing	

## Draft of Report

.04 In some cases an exposure draft of the report, clearly identified as a draft, can be used effectively to afford the client an opportunity to comment on the report before it is in final form.

## Report Production

.05 A *report guide sheet* usually accompanies all reports submitted for processing. Included in the report guide sheet is the basic information which relates to the specific client, such as:

1. Client name
2. Audit date
3. Engagement partner and manager
4. Date audit commenced
5. Date audit completed
6. Date report submitted for review
7. Date review completed
8. Date submitted for typing
9. Date submitted for checking
10. Date sent to client
11. Special comments, such as "rush," "date promised to client," and "hold for confirmation."

.06 The purpose of the report guide sheet is to enable the audit team to know the status of the report at all times, and to ascertain if there are any time lags in the processing of the report. The following procedures are used in its preparation.

*Engagement information.* The in-charge accountant enters the engagement information, delivery instructions, and "hold items" (items to be cleared prior to releasing report). He signs the report guide sheet as initial reviewer.

*Review.* The report is approved at various levels of review. If there is more than one reviewer (for example, two department reviewers for phases of a large job), the primary reviewer should sign the report guide sheet. If another partner or manager performed the entire review in the absence of the primary reviewer, then such other reviewer should sign the report guide sheet as overall reviewer.

*Processing.* The various processing levels are signed off. If more than one typist is involved, the head of the typing department or the primary typist may sign the report guide sheet. If more than one person is involved in

comparing and proofing, the person primarily responsible should sign the report guide sheet. The review partner or his delegate should sign as final reader.

*Final release.* The person who signs for final release must ascertain that all other required signatures are on the report guide sheet before releasing the report.

*Report production.* The reverse side of the report guide sheet is usually completed by the in-charge accountant. A photocopy may be given to the report production department as advance notice of production requirements (for example, where numerous printed covers will be needed).

.07 The report guide sheet is bound with the operating office's file copy of the report. With the busy atmosphere prevailing at most firms, it is of vital importance that all work as it moves through the production process be under tight control independent of the work product and its guide sheet.

.08 A simple schedule can be maintained to control the flow of work from the date an audit engagement is begun to the date the report is finally mailed to the client. The schedule has key items arranged in columnar form and can be maintained by the office manager or another person in charge of staff assignments. Frequent references to the schedule should reveal any unusual delays in completing an engagement or typing a report.

.09 To account for each report from the time it is placed for typing to the time it is mailed or delivered to the client, some firms maintain a record in the typing department, in place of or as a supplement to the foregoing record. (See Report Production Control in AAM section 9500.13.)

.10 If this record indicates any time lags, the matter should be investigated; it may indicate either an abnormal backlog of work or some other problem.

.11 In preparing the report production control form, the following procedures are suggested:

- It should be manually prepared and updated daily by a control clerk.
- It should be retained in a notebook in a readily accessible location so that audit personnel can check report status without interfering with review and production operations.
- When a report and related workpapers are received by the reviewer, the client name, report description, fiscal year end, report-letter date, and due date should be entered.
- The review partner should assign a reviewer and record the date forwarded to the reviewer and the forwarding date for tax review.
- The person's name to whom the report is given for rework (if required) should be entered and the dates forwarded for tax and audit reviews of rework are recorded (if required).
- Other dates should be recorded through final release.



**Report Guide Sheet**  
(To be bound with the—colored copy of report)

## Engagement Information

Client \_\_\_\_\_ Date Due \_\_\_\_\_

Assignment Number \_\_\_\_\_ Assignment Name \_\_\_\_\_

Partner \_\_\_\_\_ Manager \_\_\_\_\_ In-Charge Accountant \_\_\_\_\_

\_\_\_\_ Compiled Financial Statements Period \_\_\_\_\_

\_\_\_\_ Reviewed Financial Statements Period \_\_\_\_\_

\_\_\_\_ Audited Financial Statements Period \_\_\_\_\_

\_\_\_\_ Review of Interim Financial Information Period \_\_\_\_\_

\_\_\_\_ Special Reports—Description: Date \_\_\_\_\_

## Delivery Instructions:

Name—attention of: \_\_\_\_\_ Mail \_\_\_\_\_

Address: \_\_\_\_\_ Delivery by: \_\_\_\_\_

## Hold Items

Cleared by \_\_\_\_\_ Date \_\_\_\_\_

\_\_\_\_ Attorney Letter \_\_\_\_\_

\_\_\_\_ Letter of Representation \_\_\_\_\_

\_\_\_\_ \_\_\_\_\_

\_\_\_\_ \_\_\_\_\_

## Report Review:

Signature \_\_\_\_\_ Date \_\_\_\_\_

Prepared by \_\_\_\_\_

Manager \_\_\_\_\_

Review Department \_\_\_\_\_

Tax Department \_\_\_\_\_

Partner \_\_\_\_\_

## Report Processing:

Signature \_\_\_\_\_ Date \_\_\_\_\_

Typing Department \_\_\_\_\_

Comparing and Proofing \_\_\_\_\_

Final Reading \_\_\_\_\_

## Final Release:

The report(s) described above were released by me after all hold items were cleared. All appropriate levels of review were signed off, and all processing steps completed.

Signature \_\_\_\_\_ Date \_\_\_\_\_

**Report Guide Sheet (continued)**

Report Description (Exactly as it will appear):

- ☐ Financial Statements and Accountant's Report (Compilation) (Review) Report  
☐ Financial Statement and Auditor's Report  
☐ Unaudited (Interim) Financial (Statements) (Information) (and Accountant's Review Report)  
☐ Other Title
- \_\_\_\_\_
- \_\_\_\_\_

Client \_\_\_\_\_ Date \_\_\_\_\_

Report Production:

Covers: ☐ Printed ☐ Typed

Report Copies:

In covers

Client \_\_\_\_\_

File \_\_\_\_\_

Other \_\_\_\_\_

UncoveredWorkpaper copies  
(at least two)Extra file copies

Working Paper \_\_\_\_\_

Extra \_\_\_\_\_

Other Production Instructions:

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

**.13**

[illegible]

## Signing Reports

.14 After the report has been reviewed, typed, proofread, and corrected, it is usually submitted to a partner for final reading and signature.

.15 Some firms do not bind the report until after it is signed. This saves unbinding in case the signing partner orders any revisions. In offices where the reports have been sufficiently and systematically reviewed and referenced before or after typing, they may be submitted to the partner for his signature in final bound form. This saves time and additional handling.

.16 The transmittal letters and addressed envelopes should be submitted to the partner with the reports. This gives him an opportunity to review the mailing directions, so that reports are directed to the proper person.

.17 Report letters are usually signed by a partner using the firm name. Where reproducing equipment is used, a signature on the original is sufficient. There is no complimentary closing. It is important to establish rules applying to report signatures since all reports (and correspondence) issued to clients carry with them the reputation, authority, and responsibility of the firm.

## Delivery of Completed Work

.18 Audit reports are rightfully considered by clients to be confidential documents. For this reason, care should be taken to address them to a responsible person, usually the treasurer or principal executive, in an envelope clearly marked "confidential." Where there is some question as to the person or persons to whom the report should be delivered, address it to the specific source of authority authorizing the report. In a majority of cases, especially for recurring engagements, the reports are mailed. However, some firms make it a practice to have a partner deliver the report personally and discuss it with the client.

.19 The report should be mailed in envelopes or boxes sturdy enough to withstand the rough treatment they may receive in transit.

.20 Many firms send separate transmittal letters with their reports. The letter should contain no comments on the report because it might be construed as a modification of the opinion on the report. It is advisable to write a letter requesting that a printer's proof be submitted to the accounting firm for review before any printed reports are released by the client to stockholders or the public.

.21 Reports are generally issued only to the client who engaged the services. The unauthorized distribution of a report represents a violation of the confidential relationship between a firm and its client. Firms are sometimes asked by clients to mail copies of their reports directly to third parties. Clients should be discouraged from making such requests. In rare instances, where a firm assumes this added responsibility, distributions are made only upon specific written instruction from the client, and reference to the client's instructions should be included in the transmittal to the third party. Printed annual reports to shareholders, prospectuses, and other reports that are a matter of public record, such as those filed with certain governmental agencies, are obvious exceptions to this rule.

---



## AAM Section 10,000

## ACCOUNTANTS' REPORTS

These examples are for illustrative purposes only. They are included as conveniences for users of this manual who may want points of departure when drafting reports to meet their individual needs. This manual is a nonauthoritative kit of practice aids and accordingly, does not include extensive explanation or discussion of authoritative pronouncements. Users of this manual are urged to refer directly to applicable authoritative pronouncements when appropriate.

These examples illustrate the body of various reports. For comment on the heading, addressing and dating of the report, see section 10,100.

Examples which are assembled from illustrative reporting language set forth in Statements on Auditing Standards (SAS) and Statements on Standards for Accounting and Review Services (SSARS) include citation of the particular source and its location in *AICPA Professional Standards*.

## TABLE OF CONTENTS

Section	Paragraph
10,100 Format of Accountants' Reports . . . . .	.01-.11
Heading (Title) of the Report . . . . .	.01
Addressing the Report . . . . .	.02-.06
Dating the Report . . . . .	.07-.11
10,210 Unqualified Opinions . . . . .	.010-.220
Auditor's Standard Report—Comparative Financial Statements . . . . .	.010
Auditor's Standard Report—Single Year Financial Statements . . . . .	.020
Report on a Single Statement (Balance Sheet) . . . . .	.030
Reference to Other Auditors—Successor Auditor's Report When Predecessor's Report (Unqualified) Is Not Presented . . . . .	.040
Reference to Other Auditors in Report . . . . .	.050
Reference to Other Auditors—Successor Auditor's Unqualified Report When Predecessor's Report That Included an Explanatory Paragraph Is Not Presented . . . . .	.060
Reference to Other Auditors—Successor Auditor's Report When Prior Year Financial Statements Have Been Restated Following Issuance of the Predecessor's Report . . . . .	.070
Reference to Other Auditors—Prior Year Financial Statements Restated Following a Pooling of Interests . . . . .	.080
Change in Accounting Principles or Method of Accounting . . . . .	.090
Uncertainty—Litigation . . . . .	.100
Going Concern—Scope Limitation and GAAP Departures Not Present . . . . .	.110
Liquidation Basis Accounting—Uncertainty Regarding Realization of Assets and Settlement of Obligations . . . . .	.120
Liquidation Basis of Accounting—Single Year Financial Statements . . . . .	.130
Liquidation Basis of Accounting—Comparative Financial Statements . . . . .	.140
Comparative Financial Statements—Unqualified Opinion on the Current Year's Financial Statements With Disclaimer of Opinion on the Prior Year's Statements of Income, Retained Earnings, and Cash Flows . . . . .	.150

<i>Section</i>	<i>Paragraph</i>
10,210 Unqualified Opinions—continued	
Comparative Financial Statements—Subsequent Restatement of Prior Period Financial Statements to Conform With Generally Accepted Accounting Principles . . . . .	.160
Comparative Financial Statements—Current Year's Statements Audited and Prior Year's Statements Reviewed . . . . .	.170
Comparative Financial Statements—Current Year's Statements Audited and Prior Year's Statements Compiled . . . . .	.180
Comparative Financial Statements—Current Year's Statements Audited and Disclaimer on Prior Year's Unaudited Statements . . . . .	.190
U.S.—Style Report Modified to Report on Financial Statements Prepared in Conformity With Accounting Principles Generally Accepted in Another Country That Are Intended for Use Only Outside the United States . . . . .	.200
Report for a U.S. Entity That Prepares Financial Statements in Conformity With U.S. Generally Accepted Accounting Principles and Financial Statements in Conformity With Accounting Principles Generally Accepted in Another Country for Use Outside the United States . . . . .	.210
Report on Financial Statements Prepared in Conformity With the Accounting Principles Generally Accepted in Another Country That Will Have More Than Limited Distribution in the United States . . . . .	.220
10,220 Adverse Opinions . . . . .	.01
10,230 Disclaimers of Opinion . . . . .	.01-.03
Beginning Inventory Not Observed (First Examination) . . . . .	.01
Inability to Obtain Sufficient Competent Evidential Matter Due to a Scope Limitation . . . . .	.02
Scope Limitation—Inventory and GAAP Departure—Capitalized Lease Obligation . . . . .	.03
10,240 Qualified Opinions . . . . .	.010-.080
Scope Limitation—Investment in Foreign Affiliate (Assuming Effects Are Such That Qualification Rather Than Disclaimer Is Appropriate) . . . . .	.010
Departure from GAAP—Leases Not Capitalized . . . . .	.020
Departure from GAAP—Leases Not Capitalized—Pertinent Facts Disclosed in Note . . . . .	.030
Inadequate Disclosure—Omission of Disclosures . . . . .	.040
Inadequate Disclosure—Omission of Statement of Cash Flows . . . . .	.050
Change in Accounting Principle Without Reasonable Justification . . . . .	.060
Change to an Accounting Principle Not in Conformity with Generally Accepted Accounting Principles . . . . .	.070
More than One Reason—Qualified Opinion on Prior Year's Financial Statements With the Current Year Qualified for the Same Reason and an Additional Reason . . . . .	.080
10,245 Information Accompanying Audited Financial Statements . . . . .	.010-.110
Omission of Supplementary Information Required by the FASB . . . . .	.010
Omission of Supplementary Information Required by the GASB . . . . .	.015
Material Departures From FASB Guidelines on Supplementary Information . . . . .	.020
Material Departures From GASB Guidelines on Supplementary Information . . . . .	.025
Prescribed Procedures Not Completed Regarding Supplementary Information Required by the FASB . . . . .	.030
Prescribed Procedures Not Completed Regarding Supplementary Information Required by the GASB . . . . .	.035
Unresolved Doubts About Adherence to Guidelines Regarding Supplementary Information Required by FASB . . . . .	.040

<i>Section</i>	<i>Paragraph</i>
10,245 Information Accompanying Audited Financial Statements—continued	
Unresolved Doubts About Adherence to Guidelines Regarding Supplementary Information Required by GASB . . . . .	.045
Report on Accompanying Information . . . . .	.050
Disclaimer on Accompanying Information (Not Audited) . . . . .	.060
Disclaimer on Part of the Accompanying Information (Not Audited) . . . . .	.070
Qualification on Basic Financial Statements and Accompanying Information (Departure from GAAP) . . . . .	.080
Supplementary Information Required by the FASB Included in Auditor-Submitted Document . . . . .	.090
Supplementary Information Required by the GASB Included in Auditor-Submitted Documents . . . . .	.095
Consolidating Information Not Separately Examined . . . . .	.100
Unqualified Opinion on Selected Financial Data in a Client-Prepared Document That Includes Audited Financial Statements . . . . .	.110
10,250 Engagements to Report on Internal Accounting Control . . . . .	.010-.082
Unqualified Opinion on an Entity's System of Internal Accounting Control . . . . .	.010
Reporting Material Weaknesses . . . . .	.020
Study and Evaluation Made as Part of an Audit and Not Sufficient for Expressing Opinion on the System Taken as a Whole . . . . .	.030
Reporting Material Weaknesses—Study and Evaluation Made as Part of an Audit and Not Sufficient for Expressing Opinion on the System Taken as a Whole . . .	.040
Reporting Material Weaknesses in Summary Form—Study and Evaluation Made as Part of an Audit and Not Sufficient for Expressing Opinion on the System Taken as a Whole . . . . .	.041
Report Based on Criteria Established by a Regulatory Agency . . . . .	.050
Pre-Award Survey—Report Based on Criteria Established by a Regulatory Agency . . . . .	.060
Survey Made in Conjunction with an Audit—Report Based on Criteria Established by a Regulatory Agency . . . . .	.070
Report on the Design of the System of Internal Accounting Controls Maintained by a Service Organization . . . . .	.080
Report on the Design of, and Compliance with, Certain Internal Accounting Control Procedures Maintained by a Service Organization . . . . .	.081
Report on a System of Internal Accounting Control of a Segment of a Service Organization . . . . .	.082
10,260 Special Reports . . . . .	.010-.150
Cash Basis Statements . . . . .	.010
Income Tax Basis Statements . . . . .	.020
Regulatory (Statutory) Basis Statements . . . . .	.030
Rental Computation Report Based on Gross Sales . . . . .	.040
Royalties . . . . .	.050
Profit Participation . . . . .	.060
Report Relating to the Adequacy of a Provision for Income Taxes in Financial Statements . . . . .	.070
Proposed Acquisition . . . . .	.080
Claims of Creditors . . . . .	.090
Compliance with Contractual Provisions (Separate Report) . . . . .	.100
Compliance With Contractual Provisions (Auditor's Report Accompanying Financial Statements) . . . . .	.110
Compliance With Regulatory Requirements . . . . .	.120



<i>Section</i>	<i>Paragraph</i>
10,260 Special Reports—continued	
Special Purpose Financial Statements Prepared Pursuant to a Loan Agreement— Effects of Departures From Generally Accepted Accounting Principles Disclosed in a Note to the Statements . . . . .	.130
Special Purpose Financial Statements Prepared Pursuant to a Loan Agreement— Effects of Departures From Generally Accepted Accounting Principles Disclosed by Referring to Coexisting Audited Financial Statements . . . . .	.131
Special Purpose Financial Statements Prepared Pursuant to an Acquisition Agreement—Effects of Departures From Generally Accepted Accounting Principles Have Not Been Determined . . . . .	.132
Special Purpose Financial Presentation—Schedule of Gross Income and Certain Expenses . . . . .	.140
Special Purpose Financial Presentation—Statement of Assets Sold and Liabilities Transferred . . . . .	.141
Report on the Application of Accounting Principles . . . . .	.150
10,270 Unaudited Financial Statements of a Public Entity . . . . .	.01-.04
Disclaimer . . . . .	.01
Current Period Financial Statements Unaudited—Prior Period Financial Statements Audited . . . . .	.02
Disclaimer—Cash Basis Statements . . . . .	.03
Disclaimer—Regulatory (Statutory) Basis Statements . . . . .	.04
10,280 Lack of Independence . . . . .	.01
Disclaimer . . . . .	.01
10,300 Review of Interim Financial Information . . . . .	.01-.06
Accountant's Report . . . . .	.01
Accountant's Report—Comparative . . . . .	.02
Reference to Other Accountants . . . . .	.03
Departure From GAAP . . . . .	.04
Inadequate Disclosure . . . . .	.05
Restricted Scope of Review Stated in an Auditor's Report . . . . .	.06
10,400 Accountant's Report on Compilation of Financial Statements of a Nonpublic Entity . . . . .	.01-.23
Accountant's Standard Report . . . . .	.01
Omission of Substantially All Disclosures . . . . .	.02
Omission of Statement of Cash Flows and Substantially All Disclosures . . . . .	.03
Accountant Not Independent . . . . .	.04
Departure from GAAP—Omission of Statement of Cash Flows . . . . .	.05
Departure from GAAP—Accounting Principles Not Generally Accepted . . . . .	.06
Cash Basis Statements—Full Disclosure . . . . .	.07
Cash Basis Statements—Omission of Substantially All Disclosures . . . . .	.08
Income Tax Basis Statements—Full Disclosure . . . . .	.09
Income Tax Basis Statements—Omission of Substantially All Disclosures, With No Reference to Basis . . . . .	.10
Compilation Each Period—Comparative Financial Statements . . . . .	.11
Compilation Report on Current Period and Reference to Review Report on Prior Period—Comparative Financial Statements . . . . .	.12
Changed Reference to a Departure From Generally Accepted Accounting Principles—Comparative Financial Statements . . . . .	.13
Predecessor's Compilation Report on Prior Period Not Presented—Comparative Financial Statements . . . . .	.14
Predecessor's Review Report on Prior Period Not Presented—Comparative Financial Statements . . . . .	.15

<i>Section</i>	<i>Paragraph</i>
10,400 Accountant's Report on Compilation of Financial Statements of a Nonpublic Entity—continued	
Prior Period Audited—Comparative Financial Statements . . . . .	.16
Omission of Substantially All Disclosures Including Those for Prior Period Previously Not Omitted—Comparative Financial Statements . . . . .	.17
Financial Statements Accompanied by Supplementary Information . . . . .	.18
Financial Statements Included in Certain Prescribed Forms . . . . .	.19
Financial Statements Included in Certain Prescribed Forms—Departure From GAAP Not Called for by the Prescribed Forms . . . . .	.20
Uncertainty With Note Disclosure—Entity's Continued Existence ("Going Concern") . . . . .	.21
Interim Financial Statements Accompanied by a Financial Forecast Labeled as a "Budget" . . . . .	.22
Interim Financial Statements Accompanied by a Financial Forecast Labeled as an "Annual Budget" . . . . .	.23
10,500 Accountant's Report on Review of Financial Statements of a Nonpublic Entity . . . . .	.01-.15
Accountant's Standard Report . . . . .	.01
Departure from GAAP—Accounting Principles Not Generally Accepted . . . . .	.02
Departure from GAAP—Change in Accounting Principle Without Reasonable Justification . . . . .	.03
Departure from GAAP—Omission of Statement of Cash Flows . . . . .	.04
Cash Basis Statements—Full Disclosure . . . . .	.05
Income Tax Basis Statements—Full Disclosure . . . . .	.06
Review Each Period—Comparative Financial Statements . . . . .	.07
Review Report on Current Period and Reference to Compilation Report on Prior Period—Comparative Financial Statements . . . . .	.08
Changed Reference to a Departure from Generally Accepted Accounting Principles—Comparative Financial Statements . . . . .	.09
Predecessor's Review Report on Prior Period Not Presented—Comparative Financial Statements . . . . .	.10
Predecessor's Compilation Report on Prior Period Not Presented—Comparative Financial Statements . . . . .	.11
Prior Period Audited—Comparative Financial Statements . . . . .	.12
Financial Statements Accompanied by Supplementary Information Subjected to Inquiry and Analytical Procedures . . . . .	.13
Financial Statements Accompanied by Supplementary Information Not Subjected to Inquiry and Analytical Procedures . . . . .	.14
Uncertainty With Note Disclosure—Entity's Continued Existence ("Going Concern") . . . . .	.15
10,550 Accountant's Report on Condensed Financial Statements and Selected Financial Data . . . . .	.01-.03
Unqualified Opinion on Condensed Financial Statements . . . . .	.01
Adverse Opinion on Condensed Financial Statements Due to Inadequate Disclosure . . . . .	.02
Review Report on Condensed Financial Statements . . . . .	.03
10,600 Reports on Personal Financial Statements . . . . .	.01-.17
Auditor's Standard Report . . . . .	.01
Audit Report—Statement of Financial Condition Only . . . . .	.02
Audit Report—Departure from GAAP—Inappropriate Valuation Methods— Adverse Opinion . . . . .	.03

<i>Section</i>	<i>Paragraph</i>
10,600 Reports on Personal Financial Statements—continued	
Audit Report—Departure from GAAP—Inappropriate Valuation Methods— Qualified Opinion . . . . .	.04
Audit Report—Inadequate Records Preclude Opinion . . . . .	.05
Audit Report—Scope Limitation—Inadequate Records . . . . .	.06
Audit Report—Income Tax Basis . . . . .	.07
Accountants' Standard Compilation Report . . . . .	.08
Compilation Report—Statement of Financial Condition Only . . . . .	.09
Compilation Report—Omission of Substantially All Disclosures . . . . .	.10
Compilation Report—GAAP Departure—Material Assets at Cost . . . . .	.11
Compilation Report—Income Tax Basis . . . . .	.12
Compilation Report—Financial Statements Included in a Prescribed Form . . . . .	.13
Accountant's Standard Review Report . . . . .	.14
Review Report—Statement of Financial Condition Only . . . . .	.15
Review Report—GAAP Departure—Failure to Include a Provision for Estimated Income Taxes on the Differences Between the Estimated Current Value of Assets and the Estimated Current Amounts of Liabilities and Their Tax Bases . . . . .	.16
Review Report—Income Tax Basis . . . . .	.17
10,700 Accountants' Reports on Basic or General Purpose Financial Statements for State and Local Governmental Units . . . . .	.01-.20
Unqualified Opinion on General Purpose or Component Unit Financial Statements Only . . . . .	.01
Unqualified Opinion on General Purpose or Component Unit Financial Statements Submitted Together With Combining, Individual Fund, and Account Group Financial Statements and Supporting Schedules as Supplementary Data . . . . .	.02
Unqualified Opinion on General Purpose or Component Unit Financial Statements and Combining, Individual Fund, and Account Group Financial Statements Presented Together With Supporting Schedules Reported on as Supplementary Data . . . . .	.03
Unqualified Opinion on Component Unit Financial Statements of an Oversight Unit That Omit the Financial Statements of All Other Component Units . . . . .	.04
Qualified Opinion on General Purpose Financial Statements That Omit One or More, but Not All, Component Units of the Reporting Entity . . . . .	.05
Qualified Opinion on General Purpose or Component Unit Financial Statements That Omit a Fund Type or Account Group . . . . .	.06
Qualified Opinion on General Purpose or Component Unit Financial Statements That Omit a Fund From a Fund Type . . . . .	.07
Unqualified Opinion on General Fund Financial Statements With a Middle Paragraph Calling Attention to the Fact That the Financial Statements Do Not Represent the Financial Position and Results of Operations of the Governmental Unit . . . . .	.08
Unqualified Opinion on an Enterprise Fund's Financial Statements With a Middle Paragraph Calling Attention to the Fact That the Financial Statements Do Not Represent the Financial Position and Results of Operations of the Governmental Unit . . . . .	.09
Unqualified Opinion on General Purpose or Component Unit Financial Statements When a Question Arises About the Ability of a Governmental Unit to Meet Its Debts as They Come Due . . . . .	.10
Qualified Opinion on General Purpose Financial Statements That Include an Unaudited Organization, Function, or Activity . . . . .	.11
Unqualified Opinion on General Purpose Financial Statements With Reference to Audit of Part of a Fund Type by Another Auditor . . . . .	.12

## Section

## Paragraph

10,700	Accountants' Reports on Basic or General Purpose Financial Statements for State and Local Governmental Units—continued	
	Unqualified Opinion on General Purpose Financial Statements With Reference to Audit of All of a Fund Type by Another Auditor . . . . .	.13
	Report on Financial Statements Prepared in Accordance With a Comprehensive Basis of Accounting Other Than Generally Accepted Accounting Principles . . . .	.14
	Report on Supplementary Information Schedule of Federal Financial Assistance . .	.15
	Compliance Report Based on an Examination of General Purpose or Basic Financial Statements Performed in Accordance With the Standards for Audit Issued by the GAO . . . . .	.16
	Report on Compliance With Laws and Regulations Related to Major and Nonmajor Federal Financial Assistance Programs . . . . .	.17
	Report on Compliance With Laws and Regulations Related to Nonmajor Federal Financial Assistance Programs in Circumstances in Which the Recipient Received No Major Program Funding . . . . .	.18
	Report on Internal Accounting Controls Based Solely on a Study and Evaluation Made as a Part of an Examination of the General Purpose or Basic Financial Statements . . . . .	.19
	Report on Internal Controls (Accounting and Administrative)—Based on a Study and Evaluation Made as a Part of an Examination of the General Purpose or Basic Financial Statements and the Additional Tests Required by the Single Audit Act . . . . .	.20

---

[The next page is 10,101.]



# AAM Section 10,100

## *Format of Accountants' Reports*

### Heading (Title) of the Report

.01 The following table, extracted from the 1987 edition of *Accounting Trends & Techniques*,<sup>1</sup> shows the descriptive titles used in 600 stockholders' reports to identify the auditor's report:

TABLE 6-1: TITLE OF AUDITORS' REPORT

	1986	1985	1984	1983
Independent accountants' report . . . . .	184	174	174	147
Auditors' report . . . . .	122	121	116	110
Accountants' report . . . . .	65	72	77	84
Independent certified public accountants' report . . . . .	59	58	53	64
Independent auditors' report . . . . .	56	58	58	72
Certified public accountants' report . . . . .	51	50	52	53
Auditors' opinion . . . . .	24	29	29	32
Independent auditors' opinion . . . . .	7	7	8	4
Independent certified public accountants' opinion . . . . .	5	6	5	5
Independent accountants' opinion . . . . .	5	5	8	3
Accountants' opinion . . . . .	5	2	2	4
Other titles . . . . .	1	1	2	1
No title . . . . .	16	17	16	21
Total Companies . . . . .	600	600	600	600

Statement on Auditing Standards (SAS) No. 58, *Reports on Audited Financial Statements*, requires, in paragraph 8a (AU section 508.8a), that the title of the report include the word *independent*.

### Addressing the Report

.02 The accountant or auditor addresses his report to the client which retained his service.

.03 When the client is a corporation, the report may be addressed to the corporation, its board of directors or its stockholders. In practice, reports on financial statements of publicly traded corporations are usually addressed to the board of directors and shareholders.<sup>1</sup>

.04 When the client is not incorporated, the circumstances will dictate how the report should be addressed. For example, the report may be addressed to the partners, to the general partner, or to the proprietor.

.05 Occasionally, an auditor is retained to audit the financial statements of an entity that is not his client. In such instances, the report is addressed to the client and not to the board of directors, stockholders or proprietor of the entity whose financial statements are being audited.

.06 For authoritative guidance on addressing the report, see SAS No. 58, paragraph 9 (AU section 508.09).

### Dating the Report

.07 The date on an auditor's report generally indicates when the auditor completed the field work on which the report is based. Likewise, the date of an accountant's compilation report on the financial statements of a nonpublic entity, would be the date of completion of the compilation work. The date of a review report on such financial statements would be the date of completion of the accountant's inquiry and analytical procedures. Report dating involves additional considerations when the auditor becomes aware of events that occurred after comple-

<sup>1</sup> Source: *Accounting Trends & Techniques* (AICPA, New York, 1987), page 423.

tion of field work but before issuance of the report, when the report is on comparative financial statements, or when a report on prior year financial statements is reissued.

.08 When an event which is disclosed in the financial statements occurs after completion of field work but before issuance of the report, the auditor may use "dual dating," for example, "February 15, 19X1, except for Note 10 as to which the date is March 1, 19X1." In this instance, the auditor's responsibility for events occurring after February 15, 19X1 is limited to the specific event referred to in Note 10. The auditor may also date the report as of March 1, 19X1; this, however, would extend the auditor's responsibility for subsequent events to March 1, 19X1.

.09 For an auditor's report which covers financial statements of one or more prior periods (which he audited) presented on a comparative basis with those of the current period, the auditor would ordinarily date the report on the financial statements of all periods presented as of the date of his report on the most recent financial statements.

.10 When an auditor, as a predecessor, reissues a report on prior year financial statements for presentation with the report of a successor auditor on current year financial statements, the predecessor would use the date of his previous report on his reissued report to avoid the implication that he has performed any additional field work. If the predecessor auditor revises his report or if the financial statements are restated, he would dual date his report.

.11 For authoritative guidance on dating reports, see SAS No. 1, section 530; SAS No. 36, paragraph 17; SAS No. 58, paragraphs 74 and 82; and SSARS No. 1, paragraphs 15 and 33 (AU sections 530, 722.17, 508.74 and .82, and AR section 100.15 and .33, respectively).

---

[The next page is 10,211.]

# AAM Section 10,210

## *Unqualified Opinions*

### .010 Auditor's Standard Report—Comparative Financial Statements

#### Independent Auditor's Report

We have audited the accompanying balance sheets of X Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 19X2 and 19X1, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

[Signature]

[Date]

[Source: SAS No. 58, paragraph 8 (AU section 508.08).]



**.020 Auditor's Standard Report—Single Year Financial Statements****Independent Auditor's Report**

We have audited the accompanying balance sheet of X Company as of December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 19XX, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

[Signature]

[Date]

[Source: SAS No. 58, paragraph 8 (AU section 508.08).]

**.030 Report on a Single Statement (Balance Sheet)****Independent Auditor's Report**

We have audited the accompanying balance sheet of X Company as of December 31, 19XX. This financial statement is the responsibility of the Company's management. Our responsibility is to express an opinion on this financial statement based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the balance sheet is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the balance sheet. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall balance sheet presentation. We believe that our audit of the balance sheet provides a reasonable basis for our opinion.

In our opinion, the balance sheet referred to above presents fairly, in all material respects, the financial position of X Company as of December 31, 19XX, in conformity with generally accepted accounting principles.

[Signature]

[Date]

[Source: SAS No. 58, paragraph 48 (AU section 508.48).]

---

**NOTE:**

The auditor should consider the need for disclosure in his report of a loss or similar operating problems if not already adequately disclosed in the balance sheets or accompanying footnotes.

**.040 Reference to Other Auditors—Successor Auditor's Report When Predecessor's Report (Unqualified) Is Not Presented****Independent Auditor's Report**

We have audited the balance sheet of ABC Company as of December 31, 19X2, and the related statements of income, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of ABC Company as of December 31, 19X1, were audited by other auditors whose report dated March 31, 19X2, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 19X2 financial statements referred to above present fairly, in all material respects, the financial position of ABC Company as of December 31, 19X2, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

[Signature]

[Date]

[Source: SAS No. 58, paragraph 83 (AU section 508.83).]

**.050 Reference to Other Auditors in Report****Independent Auditor's Report**

We have audited the consolidated balance sheets of ABC Company as of December 31, 19X2 and 19X1, and the related consolidated statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits. We did not audit the financial statements of B Company, a wholly-owned subsidiary, which statements reflect total assets of \$\_\_\_\_\_ and \$\_\_\_\_\_ as of December 31, 19X2 and 19X1, respectively, and total revenues of \$\_\_\_\_\_ and \$\_\_\_\_\_ for the years then ended. Those statements were audited by other auditors whose report has been furnished to us, and our opinion, insofar as it relates to the amounts included for B Company, is based solely on the report of the other auditors.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based on our audits and the report of other auditors, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of ABC Company as of December 31, 19X2 and 19X1, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

[Signature]

[Date]

[Source: SAS No. 58, paragraph 13 (AU section 508.13).]

**.060 Reference to Other Auditors—Successor Auditor's Unqualified Report When Predecessor's Report That Included an Explanatory Paragraph Is Not Presented**

**Independent Auditor's Report**

We have audited the balance sheet of ABC Company as of December 31, 19X2, and the related statements of income, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of ABC Company as of December 31, 19X1, were audited by other auditors whose report dated March 1, 19X2, on those statements included an explanatory paragraph that described the litigation discussed in Note X to the financial statements.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the 19X2 financial statements referred to above present fairly, in all material respects, the financial position of ABC Company as of December 31, 19X2, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

[Signature]

[Date]

[Source: SAS No. 58, paragraph 83 (AU section 508.83).]

**.070 Reference to Other Auditors—Successor Auditor's Report When Prior Year Financial Statements Have Been Restated Following Issuance of the Predecessor's Report****Independent Auditor's Report**

We have audited the balance sheet of ABC Company as of December 31, 19X2, and the related statements of income, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit. The financial statements of ABC Company as of December 31, 19X1, before the restatement described in Note X, were audited by other auditors whose report dated March 31, 19X2, expressed an unqualified opinion on those statements.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the 19X2 financial statements referred to above present fairly, in all material respects, the financial position of ABC Company as of December 31, 19X2, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

We also reviewed the adjustments described in Note X that were applied to restate the 19X1 financial statements. In our opinion, such adjustments are appropriate and have been properly applied.

[Signature]

[Date]

[Source: SAS No. 58, paragraph 83 (AU section 508.83).]

**.080 Reference to Other Auditors—Prior Year Financial Statements Restated Following a Pooling of Interests****Independent Auditor's Report**

We have audited the accompanying consolidated balance sheet of XYZ Company as of December 31, 19X2, and the related consolidated statements of income, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the consolidated financial position of XYZ Company as of [at] December 31, 19X2, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

We previously audited and reported upon the consolidated statements of income and cash flows of XYZ Company and subsidiaries for the year ended December 31, 19X1, prior to their restatement for the 19X2 pooling of interests. The contribution of XYZ Company and subsidiaries to revenues and net income represented \_\_\_\_\_ percent and \_\_\_\_\_ percent of the respective restated totals. Separate financial statements of the other companies included in the 19X1 restated consolidated statements of income and cash flows were audited and reported upon separately by other auditors. We also have applied procedures to the combination of the accompanying consolidated statements of income and cash flows for the year ended December 31, 19X1, after restatement for the 19X2 pooling of interests; in our opinion, such consolidated statements have been properly combined on the basis described in Note A of notes to consolidated financial statements.

[Signature]

[Date]

[Source: SAS No. 1, section 543.16 as modified, October 1980, by the Auditing Standards Board (AU section 543.16).]

---

NOTE:

The auditor uses this form of reporting when he concludes he cannot serve as principal auditor for the restated financial statements. See SAS No. 1, section 543.16—.17 as modified, October 1980, by the Auditing Standards Board (AU section 543.16—.17), for guidance.

**.090 Change in Accounting Principles or Method of Accounting****Independent Auditor's Report**

We have audited the accompanying balance sheet of X Company as of December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 19XX, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

As discussed in Note X to the financial statements, the Company changed its method of computing depreciation in 19XX.

[Signature]

[Date]

[Source: SAS No. 58, paragraph 35 (AU section 508.35).]



**.100 Uncertainty—Litigation****Independent Auditor's Report**

We have audited the accompanying balance sheet of X Company as of December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 19XX, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

As discussed in Note X to the financial statements, the Company is a defendant in a lawsuit alleging infringement of certain patent rights and claiming royalties and punitive damages. The Company has filed a counteraction, and preliminary hearings and discovery proceedings on both actions are in progress. The ultimate outcome of the litigation cannot presently be determined. Accordingly, no provision for any liability that may result upon adjudication has been made in the accompanying financial statements.

[Signature]

[Date]

[Source: SAS No. 58, paragraph 32 (AU section 508.32).]

**.110 Going Concern—Scope Limitations and GAAP Departures Not Present****Independent Auditor's Report**

We have audited the accompanying balance sheet of X Company as of December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 19XX, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

The accompanying financial statements have been prepared assuming that the Company will continue as a going concern. As discussed in Note X to the financial statements, the Company has suffered recurring losses from operations and has a net capital deficiency that raise substantial doubt about its ability to continue as a going concern. Management's plans in regard to these matters are also described in Note X. The financial statements do not include any adjustments that might result from the outcome of this uncertainty.

[Signature]

[Date]

[Source: SAS No. 59, paragraph 13 (AU section 341.13).]

**.120 Liquidation Basis Accounting—Uncertainty Regarding Realization of Assets and Settlement of Obligations****Independent Auditor's Report**

We have audited the statement of net assets in liquidation of XYZ Company as of December 31, 19X2, and the related statement of changes in net assets in liquidation for the period from April 26, 19X2 to December 31, 19X2. In addition, we have audited the statements of income, retained earnings, and cash flows for the period from January 1, 19X2 to April 25, 19X2. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets in liquidation as of December 31, 19X2, and the changes in its net assets in liquidation for the period from April 26, 19X2 to December 31, 19X2, and the results of its operations and the cash flows for the period from January 1, 19X2 to April 25, 19X2, in conformity with generally accepted accounting principles applied on the bases described in the following paragraph.

As described in Note X to the financial statements, the stockholders of XYZ Company approved a plan of liquidation on April 25, 19X2, and the company commenced liquidation shortly thereafter. As a result, the company has changed its basis of accounting for periods subsequent to April 25, 19X2 from the going-concern basis to a liquidation basis. It is not presently determinable whether the amounts realizable from the disposition of the remaining assets or the amounts that creditors agree to accept in settlement of the obligations due them will differ materially from the amounts shown in the accompanying financial statements.

[Signature]

[Date]

**.130 Liquidation Basis of Accounting—Single Year Financial Statements****Independent Auditor's Report**

We have audited the accompanying statement of net assets in liquidation of X Company as of December 31, 19X2, and the related statement of changes in net assets in liquidation for the period from April 26, 19X2 to December 31, 19X2. In addition, we have audited the statements of income, retained earnings, and cash flows for the period from January 1, 19X2 to April 25, 19X2. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the net assets in liquidation of X Company as of December 31, 19X2, the changes in its net assets in liquidation for the period from April 26, 19X2 to December 31, 19X2, and the results of its operations and its cash flows for the period from January 1, 19X2 to April 25, 19X2, in conformity with generally accepted accounting principles applied on the bases described in the following paragraph.

As described in Note X to the financial statements, the stockholders of X Company approved a plan of liquidation on April 25, 19X2, and the company commenced liquidation shortly thereafter. As a result, the company has changed its basis of accounting for periods subsequent to April 25, 19X2 from the going-concern basis to a liquidation basis.

[Signature]

[Date]

**.140 Liquidation Basis of Accounting—Comparative Financial Statements****Independent Auditor's Report**

We have audited the accompanying balance sheet of X Company as of December 31, 19X1, and the related statements of income, retained earnings, and cash flows for the year then ended, and the statements of income, retained earnings, and cash flows for the period from January 1, 19X2 to April 25, 19X2. In addition, we have audited the statement of net assets in liquidation as of December 31, 19X2, and the related statement of changes in net assets in liquidation for the period from April 26, 19X2 to December 31, 19X2. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of December 31, 19X1, and the results of its operations and its cash flows for the year then ended and for the period from January 1, 19X2 to April 25, 19X2, its net assets in liquidation, as of December 31, 19X2, and the changes in its net assets in liquidation for the period from April 26, 19X2 to December 31, 19X2, in conformity with generally accepted accounting principles applied on the bases described in the following paragraph.

As described in Note X to the financial statements, the stockholders of X Company approved a plan of liquidation on April 25, 19X2, and the company commenced liquidation shortly thereafter. As a result, the company has changed its basis of accounting for periods subsequent to April 25, 19X2 from the going-concern basis to a liquidation basis.

[Signature]

[Date]

**.150 Comparative Financial Statements—Unqualified Opinion on the Current Year's Financial Statements With Disclaimer of Opinion on the Prior Year's Statements of Income, Retained Earnings, and Cash Flows**

**Independent Auditor's Report**

We have audited the accompanying balance sheets of X Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as explained in the following paragraph, we conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform our audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

We did not observe the taking of the physical inventory as of December 31, 19X0, since that date was prior to our appointment as auditors for the Company, and we were unable to satisfy ourselves regarding inventory quantities by means of other auditing procedures. Inventory amounts as of December 31, 19X0, enter into the determination of net income and cash flows for the year ended December 31, 19X1.

Because of the matter discussed in the preceding paragraph, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on the results of operations and cash flows for the year ended December 31, 19X1.

In our opinion, the balance sheets of X Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the year ended December 31, 19X2, present fairly, in all material respects, the financial position of X Company as of December 31, 19X2 and 19X1, and the results of its operations and its cash flows for the year ended December 31, 19X2, in conformity with generally accepted accounting principles.

[Signature]

[Date]

[Source: SAS No. 58, paragraph 26 (AU section 508.26).]

**.160 Comparative Financial Statements—Subsequent Restatement of Prior Period Financial Statements to Conform With Generally Accepted Accounting Principles****Independent Auditor's Report**

We have audited the accompanying balance sheets of X Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our report dated March 1, 19X2, we expressed an opinion that the 19X1 financial statements did not fairly present financial position, results of operations, and cash flows in conformity with generally accepted accounting principles because of two departures from such principles: (1) the Company carried its property, plant, and equipment at appraisal values, and provided for depreciation on the basis of such values, and (2) the Company did not provide for deferred income taxes with respect to differences between income for financial reporting purposes and taxable income. As described in Note X, the Company has changed its method of accounting for these items and restated its 19X1 financial statements to conform with generally accepted accounting principles. Accordingly, our present opinion on the 19X1 financial statements, as presented herein, is different from that expressed in our previous report.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of December 31, 19X2 and 19X1, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

[Signature]

[Date]

[Source: SAS No. 58, paragraph 78 (AU section 508.78).]

**.170 Comparative Financial Statements—Current Year's Statements Audited and Prior Year's Statements Reviewed****Independent Auditor's Report**

We have audited the accompanying balance sheet of X Company as of December 31, 19X2, and the related statements of income, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 19X2, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

The 19X1 financial statements were reviewed by us (other accountants) and our (their) report thereon, dated March 1, 19X2, stated we (they) were not aware of any material modifications that should be made to those statements for them to be in conformity with generally accepted accounting principles. However, a review is substantially less in scope than an audit and does not provide a basis for the expression of an opinion on the financial statements taken as a whole.

[Signature]

[Date]

[Source: SAS No. 26, paragraph 17 (AU section 504.17).]

---

**NOTE:**

When unaudited financial statements are presented in comparative form with audited financial statements, the unaudited financial statements should be clearly marked to indicate their status.



**.180 Comparative Financial Statements—Current Year's Statements Audited and Prior Year's Statements Compiled****Independent Auditor's Report**

We have audited the accompanying balance sheet of X Company as of December 31, 19X2, and the related statements of income, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 19X2, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

The 19X1 financial statements were compiled by us (other accountants) and our (their) report thereon, dated March 1, 19X2, stated we (they) did not audit or review those financial statements and, accordingly, express no opinion or other form of assurance on them.

[Signature]

[Date]

[Source: SAS No. 26, paragraph 17 (AU Section 504.17).]

---

**NOTE:**

When unaudited financial statements are presented in comparative form with audited financial statements, the unaudited financial statements should be clearly marked to indicate their status.

**.190 Comparative Financial Statements—Current Year's Statements Audited and Disclaimer on Prior Year's Unaudited Statements****Independent Auditor's Report**

We have audited the accompanying balance sheet of X Company as of December 31, 19X2, and the related statements of income, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 19X2, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

The 19X1 financial statements were not audited by us and, accordingly, we do not express an opinion on them.

[Signature]

[Date]

---

**NOTES:**

The above report illustrates a disclaimer of opinion as described in SAS No. 26, paragraph 17 (AU section 504.17) when the financial statements are those of a public entity. For a nonpublic entity, see AAM section 10,210.170 and .180.

When unaudited financial statements are presented in comparative form with audited financial statements, the unaudited financial statements should be clearly marked to indicate their status.

**.200 U.S.—Style Report Modified to Report on Financial Statements Prepared in Conformity With Accounting Principles Generally Accepted in Another Country That Are Intended for Use Only Outside the United States**

**Independent Auditor's Report**

We have audited the accompanying balance sheet of the International Company as of December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the year then ended, which, as described in note X, have been prepared on the basis of accounting principles generally accepted in [*name of country*]. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States (and in [*name of country*]). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of International Company as of [at] December 31, 19XX, and the results of its operations and its cash flows for the year then ended in conformity with accounting principles generally accepted in [*name of country*].

[*Signature*]

[*Date*]

**.210 Report for a U.S. Entity That Prepares Financial Statements in Conformity With U.S. Generally Accepted Accounting Principles and Financial Statements in Conformity With Accounting Principles Generally Accepted in Another Country for Use Outside the United States**

**Independent Auditor's Report**

We have audited the accompanying balance sheet of the International Company as of December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the year then ended, which, as described in Note X, have been prepared on the basis of accounting principles generally accepted in [name of country]. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States (and in [name of country]). Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

We also have reported separately on the financial statements of International Company for the same period presented in accordance with accounting principles generally accepted in the United States. (The significant differences between the accounting principles accepted in [name of country] and those generally accepted in the United States are summarized in Note X.)

[Signature]

[Date]

**.220 Report on Financial Statements Prepared in Conformity With the Accounting Principles Generally Accepted in Another Country That Will have More Than Limited Distribution in the United States**

**Independent Auditor's Report**

We have audited the accompanying balance sheet of the International Company as of December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As more fully described in Note X to the financial statements, the Company has recorded fixed assets in excess of historical cost using appraised value as the basis for adjustment in accordance with accounting principles generally accepted in [name of country]. If the fixed assets had been recorded at historical cost, fixed assets and retained earnings would be decreased by \$XXX,XXX and \$XXX,XXX respectively, as of December 31, 19XX, and net income and earnings per share would be increased by \$X,XXX and \$X.XX respectively for the year then ended.

In our opinion, except for the effects of recording the fixed assets in excess of historical costs, discussed in the preceding paragraph, the financial statements present fairly, in all material respects, the financial position of the International Company as of December 31, 19XX, and the results of its operations and the cash flows for the year then ended, in conformity with accounting principles generally accepted in the United States.

(Optional Paragraph)

In our opinion, the financial statements referred to above present fairly the financial position of the International Company at December 31, 19XX, and the results of its operations and its cash flows for the year then ended, in conformity with accounting principles generally accepted in [name of country].

[Signature]

[Date]

---

[The next page is 10,271.]

# AAM Section 10,220

## *Adverse Opinions*

### Independent Auditor's Report

.01 We have audited the accompanying balance sheets of X Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As discussed in Note X to the financial statements, the Company carries its property, plant, and equipment accounts at appraisal values, and provides depreciation on the basis of such values. Further, the Company does not provide for income taxes with respect to differences between financial income and taxable income arising because of the use, for income tax purposes, of the installment method of reporting gross profit from certain types of sales. Generally accepted accounting principles require that property, plant and equipment be stated at an amount not in excess of cost, reduced by depreciation based on such amount, and that deferred income taxes be provided.

Because of the departures from generally accepted accounting principles identified above, as of December 31, 19X2 and 19X1, inventories have been increased \$\_\_\_\_\_ and \$\_\_\_\_\_ by inclusion in manufacturing overhead of depreciation in excess of that based on cost; property, plant, and equipment, less accumulated depreciation, is carried at \$\_\_\_\_\_ and \$\_\_\_\_\_ in excess of an amount based on the cost to the Company; and deferred income taxes of \$\_\_\_\_\_ and \$\_\_\_\_\_ have not been recorded, resulting in an increase of \$\_\_\_\_\_ and \$\_\_\_\_\_ in retained earnings and in appraisal surplus of \$\_\_\_\_\_ and \$\_\_\_\_\_, respectively. For the years ended December 31, 19X2 and 19X1, cost of goods sold has been increased \$\_\_\_\_\_ and \$\_\_\_\_\_, respectively, because of the effects of the depreciation accounting referred to above and deferred income taxes of \$\_\_\_\_\_ and \$\_\_\_\_\_ have not been provided, resulting in an increase in net income of \$\_\_\_\_\_ and \$\_\_\_\_\_, respectively.

In our opinion, because of the effects of the matters discussed in the preceding paragraphs, the financial statements referred to above do not present fairly, in conformity with generally accepted accounting principles, the financial position of X Company as of December 31, 19X2 and 19X1, or the results of its operations or its cash flows for the years then ended.

[Signature]

[Date]

[Source: SAS No. 58, paragraph 69 (AU section 508.69).]

---

[The next page is 10,321.]



# AAM Section 10,230

## *Disclaimers of Opinion*

### .01 Beginning Inventory Not Observed (First Examination)

#### Independent Auditor's Report

We have audited the accompanying balance sheet of X Company as of December 31, 19X2, and were engaged to audit the related statements of income, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

Because we were not engaged as auditors until after December 31, 19X1, we were not present to observe the physical inventory taken at that date and we have not satisfied ourselves by means of other procedures concerning inventory quantities. The amount of the inventory at December 31, 19X1, enters materially into the determination of the results of operations and cash flows for the year ended December 31, 19X2. Therefore, we do not express an opinion on the accompanying statements of income and retained earnings and cash flows for the year ended December 31, 19X2.

In our opinion, the balance sheet referred to above presents fairly, in all material respects, the financial position of X Company as of [at] December 31, 19X2, in conformity with generally accepted accounting principles.

[Signature]

[Date]

[Source: SAS No. 58, paragraph 72 (AU section 508.72).]



**.02 Inability to Obtain Sufficient Competent Evidential Matter Due to a Scope Limitation****Independent Auditor's Report**

We were engaged to audit the accompanying balance sheets of X Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management.

The Company did not make a count of its physical inventory in 19X2 or 19X1, stated in the accompanying financial statements at \$\_\_\_\_\_ as of December 31, 19X2, and at \$\_\_\_\_\_ as of December 31, 19X1. Further, evidence supporting the cost of property and equipment acquired prior to December 31, 19X1, is no longer available. The Company's records do not permit the application of other auditing procedures to inventories or property and equipment.

Since the Company did not take physical inventories and we were not able to apply other auditing procedures to satisfy ourselves as to inventory quantities and the cost of property and equipment, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on these financial statements.

[Signature]

[Date]

[Source: SAS No. 58, paragraph 72 (AU section 508.72).]

**.03 Scope Limitation—Inventory and GAAP Departure—Capitalized Lease Obligations****Independent Auditor's Report**

We were engaged to audit the accompanying balance sheets of X Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management.

The Company has excluded, from property and debt in the accompanying balance sheets, certain lease obligations that, in our opinion, should be capitalized in order to conform with generally accepted accounting principles. If these lease obligations were capitalized, property would be increased by \$\_\_\_\_\_ and \$\_\_\_\_\_, long-term debt by \$\_\_\_\_\_ and \$\_\_\_\_\_, and retained earnings by \$\_\_\_\_\_ and \$\_\_\_\_\_ as of December 31, 19X2 and 19X1, respectively. Additionally, net income would be increased (decreased) by \$\_\_\_\_\_ and \$\_\_\_\_\_ and earnings per share would be increased (decreased) by \$\_\_\_\_\_ and \$\_\_\_\_\_, respectively, for the years then ended.

The Company did not make a count of its physical inventory in 19X2 or 19X1, stated in the accompanying financial statements at \$\_\_\_\_\_ as of December 31, 19X2, and at \$\_\_\_\_\_ as of December 31, 19X1. Further, evidence supporting the cost of property and equipment acquired prior to December 31, 19X1, is no longer available. The Company's records do not permit the application of other auditing procedures to inventories or property and equipment.

Since the Company did not take physical inventories and we were not able to apply other auditing procedures to satisfy ourselves as to inventory quantities and the cost of property and equipment, the scope of our work was not sufficient to enable us to express, and we do not express, an opinion on these financial statements.

[Signature]

[Date]

[Source: SAS No. 58, paragraph 72 (AU section 508.72).]

---

[The next page is 10,371.]



# AAM Section 10,240

## *Qualified Opinions*

### **.010 Scope Limitation—Investment in Foreign Affiliate (Assuming Effects Are Such That Qualification Rather Than Disclaimer Is Appropriate)**

#### **Independent Auditor's Report**

We have audited the accompanying balance sheets of X Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as discussed in the following paragraph, we conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

We were unable to obtain audited financial statements supporting the Company's investment in a foreign affiliate stated at \$\_\_\_\_\_ and \$\_\_\_\_\_ at December 31, 19X2 and 19X1, respectively, or its equity in earnings of that affiliate of \$\_\_\_\_\_ and \$\_\_\_\_\_, which is included in net income for the years then ended as described in Note X to the financial statements; nor were we able to satisfy ourselves as to the carrying value of the investment in the foreign affiliate or the equity in its earnings by other auditing procedures.

In our opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had we been able to examine evidence regarding the foreign affiliate investment and earnings, the financial statements referred to in the first paragraph above present fairly, in all material respects, the financial position of X Company as of December 31, 19X2 and 19X1, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

[Signature]

[Date]

[Source: SAS No. 58, paragraph 44 (AU section 508.44).]

**.020 Departure from GAAP—Leases Not Capitalized****Independent Auditor's Report**

We have audited the accompanying balance sheets of X Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The Company has excluded, from property and debt in the accompanying balance sheets, certain lease obligations that, in our opinion, should be capitalized in order to conform with generally accepted accounting principles. If these lease obligations were capitalized, property would be increased by \$\_\_\_\_\_ and \$\_\_\_\_\_, long-term debt by \$\_\_\_\_\_ and \$\_\_\_\_\_, and retained earnings by \$\_\_\_\_\_ and \$\_\_\_\_\_ as of December 31, 19X2 and 19X1, respectively. Additionally, net income would be increased (decreased) by \$\_\_\_\_\_ and \$\_\_\_\_\_ and earnings per share would be increased (decreased) by \$\_\_\_\_\_ and \$\_\_\_\_\_, respectively, for the years then ended.

In our opinion, except for the effects of not capitalizing certain lease obligations as discussed in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of December 31, 19X2 and 19X1, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

[Signature]

[Date]

[Source: SAS No. 58, paragraph 53 (AU section 508.53).]

**.030 Departure from GAAP—Leases Not Capitalized—Pertinent Facts Disclosed in Note****Independent Auditor's Report**

We have audited the accompanying balance sheets of X Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As more fully described in Note X to the financial statements, the Company has excluded certain lease obligations from property and debt in the accompanying balance sheets. In our opinion, generally accepted accounting principles require that such obligations be included in the balance sheets.

In our opinion, except for the effects of not capitalizing certain lease obligations as discussed in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of December 31, 19X2 and 19X1, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

[Signature]

[Date]

[Source: SAS No. 58, paragraph 54 (AU section 508.54).]

**.040 Inadequate Disclosure—Omission of Disclosures****Independent Auditor's Report**

We have audited the accompanying balance sheet of X Company as of December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the year then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The Company's financial statements do not disclose [*describe the nature of the omitted disclosures*]. In our opinion, disclosure of this information is required by generally accepted accounting principles.

In our opinion, except for the omission of the information discussed in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 19XX, and the results of its operations and its cash flows for the year then ended in conformity with generally accepted accounting principles.

[*Signature*]

[*Date*]

[Source: SAS No. 58, paragraph 56 (AU section 508.56).]

**.050 Inadequate Disclosure—Omission of Statement of Cash Flows****Independent Auditor's Report**

We have audited the accompanying balance sheets of X Company as of December 31, 19X2 and 19X1, and the related statements of income and retained earnings for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The Company declined to present a statement of cash flows for the years ended December 31, 19X2 and 19X1. Presentation of such statement summarizing the Company's operating, investing, and financing activities is required by generally accepted accounting principles.

In our opinion, except that the omission of a statement of cash flows results in an incomplete presentation as explained in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of December 31, 19X2 and 19X1, and the results of its operations for the years then ended in conformity with generally accepted accounting principles.

[Signature]

[Date]

[Source: SAS No. 58, paragraph 58 (AU section 508.58).]



**.060 Change in Accounting Principle Without Reasonable Justification****Independent Auditor's Report**

We have audited the accompanying balance sheets of X Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

As disclosed in Note X to the financial statements, the Company adopted, in 19X2, the first-in, first-out method of accounting for its inventories, whereas it previously used the last-in, first-out method. Although use of the first-in, first-out method is in conformity with generally accepted accounting principles, in our opinion the Company has not provided reasonable justification for making this change as required by generally accepted accounting principles.

In our opinion, except for the change in accounting principle discussed in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of December 31, 19X2 and 19X1, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

[Signature]

[Date]

[Source: SAS No. 58, paragraph 61 (AU section 508.61).]

**.070 Change to an Accounting Principle Not in Conformity With Generally Accepted Accounting Principles****Independent Auditor's Report**

We have audited the accompanying balance sheets of X Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The company previously recorded its land at cost but adjusted the amounts to appraised values during the year, with a corresponding increase in stockholders' equity in the amount of \$\_\_\_\_\_. In our opinion, the new basis on which land is recorded is not in conformity with generally accepted accounting principles.

In our opinion, except for the change to recording appraised values as described above, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 19X2 and 19X1, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

[Signature]

[Date]

[Source: SAS No. 58, paragraph 64 (AU section 508.64).]

**.080 More than One Reason—Qualified Opinion on Prior Year's Financial Statements With the Current Year Qualified for the Same Reason and an Additional Reason****Independent Auditor's Report**

We have audited the accompanying balance sheets of X Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

Except as discussed in the following paragraph, we conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

We were unable to obtain audited financial statements supporting the Company's investment in a foreign affiliate stated at \$\_\_\_\_\_ and \$\_\_\_\_\_ at December 31, 19X2 and 19X1, respectively, or its equity in earnings of that affiliate of \$\_\_\_\_\_ and \$\_\_\_\_\_, which is included in net income for the years then ended as described in Note X to the financial statements; nor were we able to satisfy ourselves as to the carrying value of the investment in the foreign affiliate or the equity in its earnings by other auditing procedures.

The Company has excluded, from property and debt in the accompanying 19X2 balance sheet, certain lease obligations that were entered into in 19X2, which in our opinion, should be capitalized in order to conform with generally accepted accounting principles. If these lease obligations were capitalized, property would be increased by \$\_\_\_\_\_, long-term debt by \$\_\_\_\_\_, and retained earnings by \$\_\_\_\_\_, as of December 31, 19X2. Additionally, net income would be increased (decreased) by \$\_\_\_\_\_ and earnings per share would be increased (decreased) by \$\_\_\_\_\_ for the year then ended.

In our opinion, except for the effects on the 19X2 and 19X1 financial statements of such adjustments, if any, as might have been determined to be necessary had we been able to examine evidence regarding the foreign affiliate investment and earnings, and except for the effects on the 19X2 financial statements of not capitalizing certain lease obligations as discussed in the preceding paragraph, the financial statements referred to in the the first paragraph above present fairly, in all material respects, the financial position of X Company as of December 31, 19X2 and 19X1, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

[Signature]

[Date]

[Source: SAS No. 58, paragraphs 44 and 53 (AU section 508.44 and .53).]

---

[The next page is 10,421.]

# AAM Section 10,245

## ***Information Accompanying Audited Financial Statements***

### **.010 Omission of Supplementary Information Required by the FASB**

#### **Independent Auditor's Report**

We have audited the accompanying balance sheets of X Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 19X2 and 19X1, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

The Company has not presented [*describe the supplementary information required by the FASB in the circumstances*] that the Financial Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the basic financial statements.

[Signature]

[Date]

[Source: SAS No. 52, paragraph 2 (AU section 558.02).]

**.015 Omission of Supplementary Information Required by the GASB****Independent Auditor's Report**

We have audited the accompanying general purpose financial statements of City of Example, Any State as of December 31, 19XX, and for the year then ended. These general purpose financial statements are the responsibility of City of Example, Any State management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of City of Example, Any State as of December 31, 19XX, and the results of its operations and changes in financial position of its proprietary fund types for the year then ended in conformity with generally accepted accounting principles.

The City of Example, Any State has not presented [*describe the supplementary information required by the GASB in the circumstances*] that the Governmental Accounting Standards Board has determined is necessary to supplement, although not required to be part of, the basic financial statements.

[Signature]

[Date]

[Source: SAS No. 52, paragraph 2 (AU section 558.08).]

**.020 Material Departures From FASB Guidelines on Supplementary Information****Independent Auditor's Report**

We have audited the accompanying balance sheets of X Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 19X2 and 19X1, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

The [*specifically identify the supplementary information*] on page XX is not a required part of the basic financial statements, and we did not audit and do not express an opinion on such information. However, we have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. As a result of such limited procedures, we believe that the [*specifically identify the supplementary information*] is not in conformity with guidelines established by the Financial Accounting Standards Board because [*describe the material departure(s) from the FASB guidelines*].

[Signature]

[Date]

[Source: SAS No. 52, paragraph 2 (AU section 558.08).]

---

**NOTE:**

Ordinarily, the required supplementary information should be distinct from the audited financial statements and distinguished from other information outside the financial statements that is not required by the FASB. However, management may choose not to place the required supplementary information outside the basic financial statements. In such circumstances, the information should be clearly marked as unaudited.

**.025 Material Departures From GASB Guidelines on Supplementary Information****Independent Auditor's Report**

We have audited the accompanying general purpose financial statements of City of Example, Any State as of December 31, 19XX, and for the year then ended. These general purpose financial statements are the responsibility of City of Example, Any State management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of City of Example, Any State as of December 31, 19XX, and the results of its operations and changes in financial position of its proprietary fund types for the year then ended in conformity with generally accepted accounting principles.

The [*specifically identify the supplementary information*] on page XX is not a required part of the basic financial statements, and we did not audit and do not express an opinion on such information. However, we have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. As a result of such limited procedures, we believe that the [*specifically identify the supplementary information*] is not in conformity with guidelines established by the Governmental Accounting Standards Board because [*describe the material departure(s) from the GASB guidelines*].

[Signature]

[Date]

[Source: SAS No. 52, paragraph 2 (AU section 558.08).]

---

**NOTE:**

Ordinarily, the required supplementary information should be distinct from the audited financial statements and distinguished from other information outside the financial statements that is not required by the GASB. However, management may choose not to place the required supplementary information outside the basic financial statements. In such circumstances, the information should be clearly marked as unaudited.

**.030 Prescribed Procedures Not Completed Regarding Supplementary Information Required by the FASB****Independent Auditor's Report**

We have audited the accompanying balance sheets of X Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 19X2 and 19X1, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

The [*specifically identify the supplementary information*] on page XX is not a required part of the basic financial statements, and we did not audit and do not express an opinion on such information. Further, we were unable to apply to the information certain procedures prescribed by professional standards because [*state the reasons*].

[Signature]

[Date]

[Source: SAS No. 52, paragraph 2 (AU section 558.08).]

---

**NOTES:**

Even though he is unable to complete the prescribed procedures, if, on the basis of facts known to him, the auditor concludes that the supplementary information has not been measured or presented within prescribed guidelines, he should suggest appropriate revision; failing that, he describes the nature of any material departure(s) in his report.

Ordinarily, the required supplementary information should be distinct from the audited financial statements and distinguished from other information outside the financial statements that is not required by the FASB. However, management may choose not to place the required supplementary information outside of the basic financial statements. In such circumstances, the information should be clearly marked as unaudited.



**.035 Prescribed Procedures Not Completed Regarding Supplementary Information Required by the GASB****Independent Auditor's Report**

We have audited the accompanying general purpose financial statements of City of Example, Any State as of December 31, 19XX, and for the year then ended. These general purpose financial statements are the responsibility of City of Example, Any State management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of City of Example, Any State as of December 31, 19XX, and the results of its operations and changes in financial position of its proprietary fund types for the year then ended in conformity with generally accepted accounting principles.

The [*specifically identify the supplementary information*] on page XX is not a required part of the basic financial statements, and we did not audit and do not express an opinion on such information. Further, we were unable to apply to the information certain procedures prescribed by professional standards because [*state the reasons*].

[Signature]

[Date]

[Source: SAS No. 52, paragraph 2 (AU section 558.08).]

---

**NOTE:**

Even though he is unable to complete the prescribed procedures, if, on the basis of facts known to him, the auditor concludes that the supplementary information has not been measured or presented within prescribed guidelines, he should suggest appropriate revision; failing that, he should describe the nature of any material departure(s) in his report.

**.040 Unresolved Doubts About Adherence to Guidelines Regarding Supplementary Information Required by FASB****Independent Auditor's Report**

We have audited the accompanying balance sheets of X Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 19X2 and 19X1, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

The [*specifically identify the supplementary information*] on page XX is not a required part of the basic financial statements, and we did not audit and do not express an opinion on such information. However, we have applied certain limited procedures prescribed by professional standards that raised doubts that we were unable to resolve regarding whether material modifications should be made to the information for it to conform with guidelines established by the Financial Accounting Standards Board. [*The auditor should consider including in his report the reason(s) he was unable to resolve his substantial doubts.*]

[Signature]

[Date]

[Source: SAS No. 52, paragraph 2 (AU section 558.08).]

**.045 Unresolved Doubts About Adherence to Guidelines Regarding Supplementary Information Required by GASB****Independent Auditor's Report**

We have audited the accompanying general purpose financial statements of City of Example, Any State as of December 31, 19XX, and for the year then ended. These general purpose financial statements are the responsibility of City of Example, Any State management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of City of Example, Any State as of December 31, 19XX, and the results of its operations and changes in financial position of its proprietary fund types for the year then ended in conformity with generally accepted accounting principles.

The [*specifically identify the supplementary information*] on page XX is not a required part of the basic financial statements, and we did not audit and do not express an opinion on such information. However, we have applied certain limited procedures prescribed by professional standards that raised doubts that we were unable to resolve regarding whether material modifications should be made to the information for it to conform with guidelines established by the Governmental Accounting Standards Board. [*The auditor should consider including in his report the reason(s) he was unable to resolve his substantial doubts.*]

[Signature]

[Date]

[Source: SAS No. 52, paragraph 2 (AU section 558.08).]

**.050 Report on Accompanying Information****Independent Auditor's Report**

We have audited the accompanying balance sheets of X Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 19X2 and 19X1, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The (identify accompanying information) is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has been subjected to the auditing procedures applied in the audit of the basic financial statements and, in our opinion, is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

[Signature]

[Date]

[Source: SAS No. 29, paragraph 12 (AU section 551.12).]

---

**NOTES:**

The report on the accompanying information may be added to the auditor's standard report on the basic financial statements or may appear separately in the auditor-submitted document.

This form of reporting on accompanying information is not appropriate with respect to supplementary information required by the FASB; see SAS No. 52, paragraph 3 (AU section 551.15).

**.060 Disclaimer on Accompanying Information (Not Audited)****Independent Auditor's Report**

We have audited the accompanying balance sheets of X Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 19X2 and 19X1, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The (identify the accompanying information) is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information has not been subjected to the auditing procedures applied in the audit of the basic financial statements, and, accordingly, we express no opinion on it.

[Signature]

[Date]

[Source: SAS No. 29, paragraph 13 (AU section 551.13).]

---

**NOTES:**

The report on the accompanying information may be added to the auditor's standard report on the basic financial statements or may appear separately in the auditor-submitted document.

When the auditor disclaims an opinion on all or part of the accompanying information in a document that he submits to his client or to others, such information should either be marked as unaudited or should include a reference to the auditor's disclaimer of opinion. The wording of the disclaimer will vary according to the circumstances.

**.070 Disclaimer on Part of the Accompanying Information (Not Audited)****Independent Auditor's Report**

We have audited the accompanying balance sheets of X Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 19X2 and 19X1, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The information on pages XX-YY is presented for purposes of additional analysis and is not a required part of the basic financial statements. Such information, except for that portion marked "unaudited," on which we express no opinion, has been subjected to the auditing procedures applied in the audit of the basic financial statements; and, in our opinion, the information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

[Signature]

[Date]

[Source: SAS No. 29, paragraph 13 (AU section 551.13).]

---

**NOTES:**

The report on the accompanying information may be added to the auditor's standard report on the basic financial statements or may appear separately in the auditor-submitted document.

When the auditor disclaims an opinion on all or part of the accompanying information in a document that he submits to his client or to others, such information should either be marked as unaudited or should include a reference to the auditor's disclaimer of opinion. The wording of the disclaimer will vary according to the circumstances.

**.080 Qualification on Basic Financial Statements and Accompanying Information (Departure From GAAP)****Independent Auditor's Report**

We have audited the accompanying balance sheets of X Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

The Company has excluded, from property and debt in the accompanying balance sheets, certain lease obligations that, in our opinion, should be capitalized in order to conform with generally accepted accounting principles. If these lease obligations were capitalized, property would be increased by \$\_\_\_\_\_ and \$\_\_\_\_\_, long-term debt by \$\_\_\_\_\_ and \$\_\_\_\_\_, and retained earnings by \$\_\_\_\_\_ and \$\_\_\_\_\_ as of December 31, 19X2 and 19X1, respectively. Additionally, net income would be increased (decreased) by \$\_\_\_\_\_ and \$\_\_\_\_\_ and earnings per share would be increased (decreased) by \$\_\_\_\_\_ and \$\_\_\_\_\_, respectively, for the years then ended.

In our opinion, except for the effects of not capitalizing certain lease obligations as discussed in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 19X2 and 19X1, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

Our audits were made for the purpose of forming an opinion on the basic financial statements taken as a whole. The schedules of property and related depreciation (page X), and long-term debt with related interest (page Y), as of December 31, 19X2, are presented for purposes of additional analysis and are not a required part of the basic financial statements. The information in such schedules has been subjected to the auditing procedures applied in the audit of the basic financial statements; and, in our opinion, except for the effects on the schedule of property of not capitalizing certain lease obligations as explained in the second preceding paragraph, such information is fairly stated in all material respects in relation to the basic financial statements taken as a whole.

[Signature]

[Date]

[Source: SAS No. 29, paragraph 14 and SAS No. 58, paragraph 53 (AU sections 551.14 and 508.53).]

---

**NOTE:**

The report on the accompanying information may be added to the auditor's report on the basic financial statements or may appear separately in the auditor-submitted document.

**.090 Supplementary Information Required by the FASB Included in Auditor-Submitted Document****Independent Auditor's Report**

We have audited the accompanying balance sheets of X Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 19X2 and 19X1, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

The *[identify the supplementary information]* on page XX is not a required part of the basic financial statements but is supplementary information required by the Financial Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

*[Signature]*

*[Date]*

[Source: SAS No. 52, paragraph 3 (AU section 551.15).]

---

**NOTES:**

The report on the accompanying information may be added to the auditor's standard report on the basic financial statements or may appear separately in the auditor-submitted documents.

When supplementary information required by the FASB is presented outside the basic financial statements in an auditor-submitted document, the auditor should disclaim an opinion on the information unless he has been engaged to examine and express an opinion on it.

In accordance with SAS No. 52, paragraph 2 (AU section 558.08), the auditor's report should be expanded in certain circumstances. The illustrative reports at AAM section 10,245.010—.045 are assembled from illustrative reporting language in SAS No. 52, paragraph 2 (AU section 558.08).



**.095 Supplementary Information Required by GASB Included in Auditor-Submitted Documents****Independent Auditor's Report**

We have audited the accompanying general purpose financial statements of City of Example, Any State as of December 31, 19XX, and for the year then ended. These general purpose financial statements are the responsibility of City of Example, Any State management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of City of Example, Any State as of December 31, 19XX, and the results of its operations and changes in financial position of its proprietary fund types for the year then ended in conformity with generally accepted accounting principles.

The [*identify the supplementary information*] on page XX is not a required part of the basic financial statements but is supplementary information required by the Governmental Accounting Standards Board. We have applied certain limited procedures, which consisted principally of inquiries of management regarding the methods of measurement and presentation of the supplementary information. However, we did not audit the information and express no opinion on it.

[Signature]

[Date]

[Source: SAS No. 52, paragraph 3 (AU section 551.15).]

---

**NOTES:**

The report on the accompanying information may be added to the auditor's standard report on the basic financial statements or may appear separately in the auditor-submitted documents.

When supplementary information required by the GASB is presented outside the basic financial statements in an auditor-submitted document, the auditor should disclaim an opinion on the information unless he has been engaged to audit and express an opinion on it.

In accordance with SAS No. 52, paragraph 2 (AU section 558.08), the auditor's report should be expanded in certain circumstances. The illustrative reports at AAM section 10,245.010—.045 are assembled from illustrative reporting language in SAS No. 52, paragraph 2 (AU section 558.08).

**.100 Consolidating Information Not Separately Examined****Independent Auditor's Report**

We have audited the accompanying consolidated balance sheets of X Company and subsidiaries as of December 31, 19X2 and 19X1, and the related consolidated statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of X Company and subsidiaries as of [at] December 31, 19X2 and 19X1, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

Our audits were made for the purpose of forming an opinion on the consolidated financial statements taken as a whole. The consolidating information is presented for purposes of additional analysis of the consolidated financial statements rather than to present the financial position, results of operations, and cash flows of the individual companies. The consolidating information has been subjected to the auditing procedures applied in the audit of the consolidated financial statements and, in our opinion, is fairly stated in all material respects in relation to the consolidated financial statements taken as a whole.

[Signature]

[Date]

[Source: SAS No. 29, paragraph 18 (AU section 551.18).]

---

**NOTES:**

The report on the consolidating information may be added to the auditor's standard report on the basic financial statements or may appear separately in the auditor-submitted document.

When the auditor is engaged to express an opinion only on the consolidated financial statements and consolidating information is also included, the auditor should be satisfied that the consolidating information is suitably identified. For example, when the consolidated financial statements include columns of information about the components of the consolidated group, the balance sheets might be titled, "Consolidated Balance Sheet—December 31, 19X1, with Consolidating Information," and the columns including the consolidating information might be marked, "Consolidating Information." When the consolidating information is presented in separate schedules, the schedules presenting balance sheet information of the components might be titled, for example, "Consolidating Schedule, Balance Sheet Information, December 31, 19X1."

**.110 Unqualified Opinion on Selected Financial Data in a Client-Prepared Document That Includes Audited Financial Statements****Independent Auditor's Report**

We have audited the accompanying consolidated balance sheets of X Company and subsidiaries as of December 31, 19X5 and 19X4, and the related consolidated statements of income, retained earnings, and cash flows for each of the three years in the period ended December 31, 19X5. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the consolidated financial statements referred to above present fairly, in all material respects, the financial position of X Company and subsidiaries as of [at] December 31, 19X5 and 19X4, and the results of its operations and its cash flows for each of the three years in the period ended December 31, 19X5 in conformity with generally accepted accounting principles.

We have also previously audited, in accordance with generally accepted auditing standards, the consolidated balance sheets as of December 31, 19X3, 19X2, and 19X1, and the related consolidated statements of income, retained earnings, and cash flows for the years ended December 31, 19X2 and 19X1 (none of which are presented herein); and we expressed unqualified opinions on those consolidated financial statements. In our opinion, the information set forth in the selected financial data for each of the five years in the period ended December 31, 19X5, appearing on page XX, is fairly stated in all material respects in relation to the consolidated financial statements from which it has been derived.

[Signature]

[Date]

---

[The next page is 10,471.]

# AAM Section 10,250\*

## ***Engagements to Report on Internal Accounting Control***

### **.010 Unqualified Opinion on an Entity's System of Internal Accounting Control**

We have made a study and evaluation of the system of internal accounting control of XYZ Company and subsidiaries in effect at (date). Our study and evaluation was conducted in accordance with standards established by the American Institute of Certified Public Accountants.

The management of XYZ Company is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles.

Because of inherent limitations in any system of internal accounting control, errors or irregularities may occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with the procedures may deteriorate.

In our opinion, the system of internal accounting control of XYZ Company and subsidiaries in effect at (date), taken as a whole, was sufficient to meet the objectives stated above insofar as those objectives pertain to the prevention or detection of errors or irregularities in amounts that would be material in relation to the consolidated financial statements.

[Source: SAS No. 30, paragraph 39 (AU section 642.39).]

---

\* Note: The reports in AAM section 10,250, paragraphs .010—.082 will be changed, in future updates, to conform to changes made to SAS No. 30, *Reporting on Internal Accounting Control* (AU section 642), Interpretations of SAS No. 30 (AU section 9642), and SAS No. 44, *Special-Purpose Reports on Internal Accounting Control at Service Organizations* (AU section 324).

**.020 Reporting Material Weaknesses**

We have made a study and evaluation of the system of internal accounting control of XYZ Company and subsidiaries in effect at (date). Our study and evaluation was conducted in accordance with standards established by the American Institute of Certified Public Accountants.

The management of XYZ Company is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles.

Because of inherent limitations in any system of internal accounting control, errors or irregularities may occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with the procedures may deteriorate.

Our study and evaluation disclosed the following conditions in the system of internal accounting control of XYZ Company and subsidiaries in effect at (date), which, in our opinion, result in more than a relatively low risk that errors or irregularities in amounts that would be material in relation to the consolidated financial statements may occur and not be detected within a timely period.

**Comment**

The report should describe the material weaknesses, state whether they result from the absence of control procedures or the degree of compliance with them, and describe the general nature of potential errors or irregularities that may occur as a result of the weaknesses.

The accountant may want to report to management other weaknesses even though they are not considered to be material. Comments on such other weaknesses should be clearly distinguished from those relating to material weaknesses. If some weaknesses are reported to one group but not to another (for example, to management but not to regulatory agencies), the more extensive report should distinguish the weaknesses that are excluded from the other report, and the accountant should be prepared to support, if necessary, his judgment in making the distinction.

If management has implemented control procedures to correct the weakness, the accountant should not refer to this corrective action unless he has satisfied himself that the procedures are suitably designed and are being applied as prescribed.

If the opinion on the internal accounting control system is issued in conjunction with an examination of the entity's financial statements, the following sentence should be included in the paragraph that describes the material weakness:

These conditions were considered in determining the nature, timing, and extent of audit tests to be applied in our examination of the 19XX financial statements, and this report does not affect our report on these financial statements dated (date of report).

[Source: SAS No. 30, paragraphs 39—40 and 43 (AU section 642.39—.40 and .43).]

**.030 Study and Evaluation Made as Part of an Audit and Not Sufficient for Expressing Opinion on the System Taken as a Whole<sup>1</sup>**

To the Board of Directors of XYZ Company:

We have examined the financial statements of XYZ Company for the year ended December 31, 19X1, and have issued our report thereon dated February 23, 19X2 <sup>2</sup>. As part of our examination, we made a study and evaluation of the Company's system of internal accounting control to the extent we considered necessary to evaluate the system as required by generally accepted auditing standards. The purpose of our study and evaluation was to determine the nature, timing, and extent of the auditing procedures necessary for expressing an opinion on the company's financial statements. Our study and evaluation was more limited than would be necessary to express an opinion on the system of internal accounting control taken as a whole.

The management of XYZ Company is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles.

Because of inherent limitations in any system of internal accounting control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

Our study and evaluation made for the limited purpose described in the first paragraph would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the system of internal accounting control of XYZ Company taken as a whole. However, our study and evaluation disclosed no condition that we believed to be a material weakness.

This report is intended solely for the use of management (or specified regulatory agency or other specified third party) and should not be used for any other purpose.

[Source: SAS No. 30, paragraph 49 (AU section 642.49).]

---

<sup>1</sup> When the study and evaluation made as part of an audit is sufficient for expressing an opinion on the system, see SAS No. 30, *Reporting on Internal Accounting Control*, paragraphs 37—46 (AU section 642.37—46).

<sup>2</sup> If the report on an examination of the financial statements is qualified because of a restriction on the scope of the examination, the restriction and its effect on the evaluation of the system of internal accounting control should be indicated in the report. If a portion of the examination has been performed by other auditors, the principal auditor's report should make it clear that it does not cover the entities examined by the other auditors. If the other auditors have issued a report concerning material weaknesses, the principal auditor may wish to, but is not required to, refer to such report of the other auditors.

**.040 Reporting Material Weaknesses—Study and Evaluation Made as Part of an Audit and Not Sufficient for Expressing Opinion on the System Taken as a Whole<sup>3</sup>**

To the Board of Directors of XYZ Company:

We have examined the financial statements of XYZ Company for the year ended December 31, 19X1, and have issued our report thereon dated February 23, 19X2.<sup>4</sup> As part of our examination, we made a study and evaluation of the Company's system of internal accounting control to the extent we considered necessary to evaluate the system as required by generally accepted auditing standards. The purpose of our study and evaluation was to determine the nature, timing, and extent of the auditing procedures necessary for expressing an opinion on the company's financial statements. Our study and evaluation was more limited than would be necessary to express an opinion on the system of internal accounting control taken as a whole.

The management of XYZ Company is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles.

Because of inherent limitations in any system of internal accounting control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

Our study and evaluation made for the limited purpose described in the first paragraph would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the system of internal accounting control of XYZ Company taken as a whole. However, our study and evaluation disclosed the following conditions that we believe result in more than a relatively low risk that errors or irregularities in amounts that would be material in relation to the financial statements of XYZ Company may occur and not be detected within a timely period.<sup>5</sup> (A description of the material weaknesses that have come to the auditor's attention would follow.)

These conditions were considered in determining the nature, timing, and extent of the audit tests to be applied in our examination of the 19X1 financial statements, and this report does not affect our report on these financial statements dated (date of report).

This report is intended solely for the use of management (or specified regulatory agency or other specified third party) and should not be used for any other purpose.

---

<sup>3</sup> When the study and evaluation made as part of an audit is sufficient for expressing an opinion on the system, see SAS No. 30, *Reporting on Internal Accounting Control*, paragraphs 37—46 (AU section 642.37—.46).

<sup>4</sup> If the report on an examination of the financial statements is qualified because of a restriction on the scope of the examination, the restriction and its effect on the evaluation of the system of internal accounting control should be indicated in the report. If a portion of the examination has been performed by other auditors, the principal auditor's report should make it clear that it does not cover the entities examined by the other auditors. If the other auditors have issued a report concerning material weaknesses, the principal auditor may wish to, but is not required to, refer to such report of the other auditors.

<sup>5</sup> If the auditor is aware of a material weakness in internal accounting control, whether or not he is specifically engaged by the client to review and report on the system of internal accounting control, a communication as described in SAS No. 20, *Required Communication of Material Weaknesses in Internal Accounting Control* (AU section 323), is required. For the form of such communication see SAS No. 20, paragraph 8 (AU section 323.08), as amended by SAS No. 30 (AU section 642).

**Comment**

The description of the weaknesses should include indication of whether they result from the absence of control procedures or the degree of compliance with them, and describe the general nature of potential errors or irregularities that may occur as a result of the weaknesses. (However, if the auditor becomes aware of material weaknesses for which management believes corrective action is not practicable, he may refer to the circumstances and summarize the weaknesses; a detailed communication of the circumstances and the related weaknesses is not required. See AAM § 10,250.041 for an illustration of reporting material weaknesses in summary form.)

The auditor may want to report other weaknesses even though they are not considered to be material. Comments on such weaknesses should be clearly distinguished from those relating to material weaknesses. If some weaknesses are reported to one group but not to another (for example, to management but not to regulatory agencies), the more extensive report should distinguish the weaknesses that are excluded from the other report, and the auditor should be prepared to support, if necessary, his judgment in making the distinction.

[Source: SAS No. 30, paragraph 49—51 (AU section 642.49—.51).]



**.041 Reporting Material Weaknesses in Summary Form—Study and Evaluation Made as Part of an Audit and Not Sufficient for Expressing Opinion on the System Taken as a Whole<sup>6</sup>**

To the Board of Directors of XYZ Company:

As part of our examination of your financial statements for the year ended December 31, 19X1, as described in our engagement letter dated October 1, 19X1, we studied the Company's system of internal accounting control to the extent we considered necessary to evaluate the system as required by generally accepted auditing standards to enable us to express an opinion on your financial statements.<sup>7</sup>

Such a study and evaluation does not necessarily cover all aspects of internal accounting control and might not detect all weaknesses in the system. Accordingly, we do not express an opinion on the system of internal accounting control of XYZ Company taken as a whole. However, as indicated in the following paragraph, it disclosed certain conditions that we believe to be material weaknesses. A material weakness is a condition in which the specific control procedures or the degree of compliance with them do not reduce to a relatively low level the risk that material errors or irregularities may occur and not be detected within a timely period by your employees in the normal course of performing their assigned functions.<sup>8</sup>

(Example of a Material Weakness:)

An inadequate segregation of duties exists with respect to cash transactions that results in inadequate control over cash sales, collections of accounts receivable, and cash disbursements.

We considered these conditions in determining the audit tests to be applied in our examination of your 19X1 financial statements. In addition, we have discussed them with \_\_\_\_\_ who has indicated that due to the limited number of personnel, an adequate segregation of duties is not achievable and that the costs of correcting the weakness would exceed the benefits that would be derived.

This letter should not be distributed outside the Company.

---

<sup>6</sup> When the study and evaluation made as part of an audit is sufficient for expressing an opinion on the system, see SAS No. 30, *Reporting on Internal Accounting Control*, paragraphs 37—46 (AU section 642.37—46).

<sup>7</sup> If the report on an examination of the financial statements is qualified because of a restriction on the scope of the examination, the restriction and its effect on the evaluation of the system of internal accounting control should be indicated in the report. If a portion of the examination has been performed by other auditors, the principal auditor's report should make it clear that it does not cover the entities examined by the other auditors. If the other auditors have issued a report concerning material weaknesses, the principal auditor may wish to, but is not required to, refer to such report of the other auditors.

<sup>8</sup> If the auditor is aware of material weaknesses in internal accounting control, whether or not he is specifically engaged by the client to review and report on the system of internal accounting control, a communication as described in SAS No. 20, *Required Communication of Material Weaknesses in Internal Accounting Control* (AU section 323), is required. If management believes it is not practicable to correct such weaknesses of SAS No. 20, paragraph 9 (AU section 323.09), provides that the auditor may refer to the circumstances and summarize the weaknesses; a detailed communication of the circumstances and the related weaknesses is not required.

**.050 Report Based on Criteria Established by a Regulatory Agency**

We understand that (recipient) has been awarded a grant of (amount) from (agency) for the period from (date) through (date) for use in accordance with the (title or description of program). We have made a study of those internal accounting control and administrative control procedures of (recipient) that we considered relevant to the criteria established by (agency), as set forth in (section) of its audit guide, issued (date). Our study included tests of compliance with such procedures during the period from (date) through (date). Our study did not constitute an audit of any financial statements prepared by (recipient).

The management of (recipient) is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. We understand that the objective of those administrative control procedures comprehended in the (agency's) criteria is to provide similar assurance as to compliance with its related requirements.

Because of inherent limitations in any system of internal accounting control, errors or irregularities may occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with the procedures may deteriorate.

We understand that procedures in conformity with the criteria referred to in the first paragraph of this report are considered by the (agency) to be adequate for its purpose in accordance with (name of Act) and related regulations, and that procedures not in conformity with those criteria indicate some inadequacy for such purposes. Based on this understanding and on our study, we believe (recipient's) procedures were adequate for the agency's purposes, except for the conditions described (reference to appropriate section of report), which we believe are material weaknesses in relation to the grant to which this report refers. In addition to these weaknesses, other conditions that we believe are not in conformity with the criteria referred to above are described (reference to appropriate section of report).

This report is intended for the information of (recipient) and (agency) and should not be used for any other purpose.

[Source: SAS No. 30, paragraphs 39 and 59 (AU section 642.39 and .59).]

**.060 Pre-Award Survey—Report Based on Criteria Established by a Regulatory Agency**

We understand that (applicant) has applied for a grant of (amount) from (agency) for the period from (date) through (date) for use in accordance with the (title or description of program). We have made a study of the design of those internal accounting control and administrative control procedures of (applicant) that we considered relevant to the criteria established by (agency), as set forth in (section) of its audit guide, issued (date). Since our study related to procedures (applicant) proposes to follow if the grant is awarded, it did not include tests of compliance with such procedures. Our study did not constitute an audit of any financial statements prepared by (applicant).

The management of (applicant) is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. We understand that the objective of those administrative control procedures comprehended in the (agency's) criteria is to provide similar assurance as to compliance with its related requirements.

Because of inherent limitations in any system of internal accounting control, errors or irregularities may occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with the procedures may deteriorate.

We understand that procedures in conformity with the criteria referred to in the first paragraph of this report are considered by the (agency) to be adequate for its purpose in accordance with (name of Act) and related regulations, and that procedures not in conformity with those criteria indicate some inadequacy for such purposes. Based on this understanding and on our study, we believe (applicant's) procedures would be adequate for the agency's purposes assuming satisfactory compliance, except for the conditions described (reference to appropriate section of report), which we believe would be material weaknesses in relation to the grant to which this report refers.<sup>9</sup> In addition to these weaknesses, other conditions that we believe would not be in conformity with the criteria referred to above are described (reference to appropriate section of report).

This report is intended for the information of (applicant) and (agency) should not be used for any other purpose.

[Source: Interpretation No. 1 of SAS No. 30 (AU section 9642.01—.03).]

---

<sup>9</sup> If the auditor is aware of a material weakness in internal accounting control, whether or not he is specifically engaged by the client to review and report on the system of internal accounting control, a communication as described in SAS No. 20, *Required Communication of Material Weaknesses in Internal Accounting Control* (AU section 323), is required. For the form of such communication see SAS No. 20, paragraph 8 (AU section 323.08), as amended by SAS No. 30 (AU section 642).

**.070 Survey Made in Conjunction With an Audit—Report Based on Criteria Established by a Regulatory Agency**

We understand that (recipient) has been awarded a grant of (amount) from (agency) for the period from (date) through (date) for use in accordance with the (title or description of program). We have made a study of those internal accounting control and administrative control procedures of (recipient) that we considered relevant to the criteria established by (agency), as set forth in (section) of its audit guide, issued (date). Our study included tests of compliance with such procedures during the period from (date) through (date). We have examined the financial statements of (recipient) for the year ended (date) and have issued our report therein dated (date).<sup>10</sup>

The management of (recipient) is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. We understand that the objective of those administrative control procedures comprehended in the (agency's) criteria is to provide similar assurance as to compliance with its related requirements.

Because of inherent limitations in any system of internal accounting control, errors or irregularities may occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with the procedures may deteriorate.

We understand that procedures in conformity with the criteria referred to in the first paragraph of this report are considered by the (agency) to be adequate for its purpose in accordance with (name of Act) and related regulations, and that procedures not in conformity with those criteria indicate some inadequacy for such purposes. Based on this understanding and on our study, we believe (recipient's) procedures were adequate for the agency's purposes, except for the conditions described (reference to appropriate section of report), which we believe are material weaknesses in relation to the grant to which this report refers.<sup>11</sup> In addition to these weaknesses, other conditions that we believe are not in conformity with the criteria referred to above are described (reference to appropriate section of report).

These conditions were considered in determining the nature, timing, and extent of the audit tests to be applied in our examination of the 19X1 financial statements, and this report does not affect our report on those financial statements dated (date of report).

This report is intended for the information of (recipient) and (agency) and should not be used for any other purpose.

[Source: Interpretation No. 1 of SAS No. 30 (AU section 9642.01—.03).]

---

<sup>10</sup> If the report on an examination of the financial statements is qualified because of a restriction on the scope of the examination, the restriction and its effect on the evaluation of the system of internal accounting control should be indicated in the report. If a portion of the examination has been performed by other auditors, the principal auditor's report should make it clear that it does not cover the entities examined by the other auditors. If the other auditors have issued a report concerning material weaknesses, the principal auditor may wish to, but is not required to, refer to such report of the other auditors.

<sup>11</sup> If the auditor is aware of a material weakness in internal accounting control, whether or not he is specifically engaged by the client to review and report on the system of internal accounting control, a communication as described in SAS No. 20, *Required Communication of Material Weaknesses in Internal Accounting Control* (AU section 323), is required. For the form of such communication, see SAS<sup>2</sup> No. 20, paragraph 8 (AU section 323.08), as amended by SAS No. 30 (AU section 642).

**.080 Report on the Design of the System of Internal Accounting Controls Maintained by a Service Organization\***

To the Blank Service Center:

We have reviewed the accompanying description of the operations and control procedures of the Blank Service Center related to its payroll processing system as of (date) and identified specific control objectives and the procedures that achieve those objectives. Our review included procedures we considered necessary in the circumstances to evaluate the design of the control procedures specified in section 2. We did not test compliance with the control procedures and, accordingly, we do not express an opinion on whether those controls were being applied as prescribed for any period of time or on whether the system, taken as a whole, meets the objectives of internal accounting control. A further description of our review and its objections is attached.

Because of inherent limitations in any system of internal accounting control, errors or irregularities may occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions.

In our opinion, the control procedures included in the accompanying description of the payroll processing system of the Blank Service Center as of (date) are suitably designed to provide reasonable, but not absolute, assurance that the control objectives specified in section 2 would be achieved if the control procedures were complied with satisfactorily.

This report is intended solely for use by management of Blank Service Center, its customers, and the independent auditors of its customers.

[Source: SAS No. 44, paragraph 35 (AU section 324.35).]

---

\* The report assumes that the description of operations and control procedures is divided into two sections: section 1 is the service organization's description of the system; section 2 lists specific control objectives and describes control procedures that achieve those objectives.

**.081 Report on the Design of, and Compliance with, Certain Internal Accounting Control Procedures Maintained by a Service Organization\***

To the Blank Service Center:

We have reviewed the accompanying description of the operations and control procedures of the Blank Service Center related to its payroll processing system and identified specific control objectives and the procedures that achieve those objectives. Our review, covering the period from (date) to (date), included such tests as we considered necessary to evaluate whether the procedures described in section 2 and the extent of compliance with them are sufficient to provide reasonable, but not absolute, assurance that the control objectives specified therein were achieved. We tested compliance only with the control procedures listed in section 2. Accordingly, we do not express an opinion on whether all of the controls described in section 1 were being applied as prescribed for any period of time or on whether the system, taken as a whole, meets the objectives of internal accounting control. A further description of our review and its objectives is attached.

Because of inherent limitations in any system of internal accounting control, errors or irregularities may occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions, or that the degree of compliance with the procedures may deteriorate.

In our opinion, the control procedures of the Blank Service Center payroll processing system described in section 2 and the degree of compliance with them were sufficient to provide reasonable, but not absolute, assurance that the control objectives specified therein were achieved for the period from (date) to (date).

This report is intended solely for use by management of Blank Service Center, its customers, and the independent auditors of its customers.

[Source: SAS No. 44, paragraph 41 (AU section 324.41).]

---

\* The report assumes that the description of operations and control procedures is divided into two sections: Section 1 is the service organization's description of the system; section 2 lists specific control objectives and describes control procedures that achieve those objectives.

**.082 Report on a System of Internal Accounting Control of a Segment of a Service Organization**

To the Blank Bank and Trust Company:

We have made a study and evaluation of the system of internal accounting control of the trust department of Blank Bank and Trust Company that existed during the period from (date) to (date), which department has responsibility for personal, custodial, and corporate trust accounts. Our study and evaluation was conducted in accordance with standards established by the American Institute of Certified Public Accountants.

The management of Blank Bank and Trust Company is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of such a system are to provide management with reasonable, but not absolute, assurance that assets for which the trust department has responsibility are safeguarded against loss from unauthorized use or disposition and that transactions are executed in accordance with management's authorization and in conformity with the governing instruments and are recorded properly to permit the preparation of the required financial reports.

Because of inherent limitations in any system of internal accounting control, errors or irregularities may occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

In our opinion, the system of internal accounting control of the trust department of Blank Bank and Trust Company that existed during the period from (date) to (date), taken as a whole, was sufficient to meet the objectives stated above insofar as those objectives pertain to the prevention or detection of errors or irregularities in amounts that would be material in relation to the financial statements of Blank Bank and Trust Company.

[Source: SAS No. 44, paragraph 46 (AU section 324.46).]

---

[The next page is 10,521.]

# AAM Section 10,260\*

## *Special Reports*

### .010 Cash Basis Statements

We have examined the statement of assets and liabilities arising from cash transactions of XYZ Company as of December 31, 19XX, and the related statement of revenue collected and expenses paid for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As described in Note X, the Company's policy is to prepare its financial statements on the basis of cash receipts and disbursements; consequently, certain revenue and the related assets are recognized when received rather than when earned, and certain expenses are recognized when paid rather than when the obligation is incurred. Accordingly, the accompanying financial statements are not intended to present financial position and results of operations in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly the assets and liabilities arising from cash transactions of XYZ Company as of December 31, 19XX, and the revenue collected and expenses paid during the year then ended, on the basis of accounting described in Note X, which basis has been applied in a manner consistent with that of the preceding year.

[Source: SAS No. 14, paragraph 8 (AU section 621.08).]

---

\* Note: Reports in this section may be changed in future updates as a result of an exposure draft to conform SAS No. 14, *Special Reports* (AU section 621), to SAS No. 58, *Reports on Audited Financial Statements* (AU section 508).



**.020 Income Tax Basis Statements**

We have examined the statement of assets, liabilities, and capital—income tax basis of ABC Partnership as of December 31, 19XX, and the related statements of revenue and expenses—income tax basis and of changes in partners' capital accounts—income tax basis for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As described in Note X, the Partnership's policy is to prepare its financial statements on the accounting basis used for income tax purposes; consequently, certain revenue and the related assets are recognized when received rather than when earned, and certain expenses are recognized when paid rather than when the obligation is incurred. Accordingly, the accompanying financial statements are not intended to present financial position and results of operations in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly the assets, liabilities, and capital of ABC Partnership as of December 31, 19XX, and its revenue and expenses and charges in its partners' capital accounts for the year then ended, on the basis of accounting described in Note X, which basis has been applied in a manner consistent with that of the preceding year.

[Source: SAS No. 14, paragraph 8 (AU section 621.08).]

**.030 Regulatory (Statutory) Basis Statements**

We have examined the financial statements and schedules of XYZ surplus—statutory basis of XYZ Insurance Company as of December 31, 19XX, and the related statements of income—statutory basis and changes in surplus—statutory basis for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As described in Note X, the Company's policy is to prepare its financial statements on the basis of accounting practices prescribed or permitted by the Insurance Department of [state]. These practices differ in some respects from generally accepted accounting principles. Accordingly, the accompanying financial statements are not intended to present financial position and results of operations in conformity with generally accepted accounting principles. This report is intended solely for filing with regulatory agencies and is not intended for any other purpose.

In our opinion, the financial statements referred to above present fairly the admitted assets, liabilities and surplus of XYZ Insurance Company as of December 31, 19XX, and the results of its operations and changes in its surplus for the year then ended, on the basis of accounting described in Note X, which basis has been applied in a manner consistent with that of the preceding year.

[Source: SAS No. 14, paragraph 8 (AU section 621.08).]

**.040 Rental Computation Report Based on Gross Sales**

Board of Directors

ABC Company

We have examined the schedule of gross sales (as defined in the lease agreement dated March 4, 19XX, between ABC Company, as lessor, and XYZ Stores Corporation, as lessee) of XYZ Stores Corporation at its Main Street store, [City], [State], for the year ended December 31, 19XX. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the schedule of gross sales referred to above presents fairly the gross sales of XYZ Stores Corporation at its Main Street store, [City], [State], for the year ended December 31, 19XX, on the basis specified in the lease agreement referred to above.

[Source: SAS No. 14, paragraph 14 (AU section 621.14).]

**.050 Royalties**

Board of Directors  
XYZ Corporation

We have examined the schedule of royalties applicable to engine production of the Q Division of XYZ Corporation for the year ended December 31, 19XX, under the terms of a license agreement dated May 14, 19XX, between ABC Company and XYZ Corporation. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

We have been informed that, under XYZ Corporation's interpretation of the agreement referred to above, royalties were based on the number of engines produced after giving effect to a reduction for production retirements that were scrapped, but without a reduction for field returns that were scrapped, even though the field returns were replaced with new engines without charge to customers. This treatment is consistent with that followed in prior years.

In our opinion, the schedule of royalties referred to above presents fairly the number of engines produced by the Q Division of XYZ Corporation during the year ended December 31, 19XX, and the amount of royalties applicable thereto under the license agreement referred to above, on the basis indicated in the preceding paragraph.

[Source: SAS No. 14, paragraph 14 (AU section 621.14).]

**.060 Profit Participation<sup>1</sup>**

Mr. John Smith

We have examined XYZ Company's schedule of John Smith's profit participation for the year ended December 31, 19X1. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances. We have examined the financial statements of XYZ Company for the year ended December 31, 19X1, and have issued our report thereon dated March 10, 19X2.

We have been informed that the documents that govern the determination of John Smith's profit participation are (a) the employment agreement between John Smith and XYZ Company dated February 1, 19X0, (b) the production and distribution agreement between XYZ Company and Television Network Incorporated dated March 1, 19X0, and (c) the studio facilities agreement between XYZ Company and QRX Studios dated April 1, 19X0, as amended November 1, 19X0.

In our opinion, the schedule of profit participation referred to above presents fairly John Smith's participation in the profits of XYZ Company for the year ended December 31, 19X1, in accordance with the provisions of the agreements referred to in the preceding paragraph.

[Source: SAS No. 14, paragraph 14 (AU section 621.14).]

---

<sup>1</sup> A report on an examination of a schedule of profit participation should be issued only if the auditor has examined the financial statements on which the participation is based.

**.070 Report Relating to the Adequacy of a Provision for Income Taxes in Financial Statements<sup>2</sup>**

We have examined the financial statements of XYZ Company, Inc., for the year ended June 30, 19XX, and have issued our report thereon dated August 15, 19XX. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In the course of our examination, we examined the provision for federal and state income taxes for the year ended June 30, 19XX, included in the Company's financial statements referred to in the preceding paragraph. We also reviewed the federal and state income tax returns filed by the Company that are subject to examination by the respective taxing authorities.

In our opinion, the Company has paid or has provided adequate accruals in the financial statements referred to above for the payment of all federal and state income taxes, and has provided for related deferred income taxes, applicable to fiscal 19XX and prior fiscal years, that could be reasonably estimated at the time of our examination of the financial statements of XYZ Company, Inc., for the year ended June 30, 19XX.

[Source: SAS No. 14, paragraph 14 (AU section 621.14).]

---

<sup>2</sup> A report relating to the adequacy of a provision for income taxes in financial statements should be issued only if the auditor has examined the financial statements in which the provision appears.

If a significant period of time has elapsed between the date of the auditor's report on the financial statements and the date he is reporting on the provision for income taxes, the auditor may wish to include the following paragraph in his report:

Because we have not examined any financial statements of XYZ Company, Inc., as of any date or for any period subsequent to June 30, 19XX, we have no knowledge of the effects, if any, on the income tax provision of events that may have occurred subsequent to the date of our examination.

**.080 Proposed Acquisition**

Board of Directors  
X Company

We have applied certain agreed-upon procedures, as discussed below, to accounting records of Y Company, Inc., as of December 31, 19XX, solely to assist you in connection with the proposed acquisition of Y Company, Inc. It is understood that this report is solely for your information and is not to be referred to or distributed for any purpose to anyone who is not a member of management of X Company. Our procedures and findings are as follows:

- a. We reconciled cash on deposit with the following banks to the balances in the respective general ledger accounts and obtained confirmation of the related balances from the banks.

<u>Bank</u>	<u>Balance Per General Ledger</u>
ABC National Bank .....	\$5,000
DEF State Bank .....	13,776
XYZ Trust Company—regular account .....	86,912
XYZ Trust Company—payroll account .....	5,000

- b. We obtained an aged trial balance of the accounts receivable subsidiary records, traced the age and amounts of approximately 10 percent of the accounts to the accounts receivable ledger, and added the trial balance and compared the total with the balance in the general ledger control account. We mailed requests for positive confirmation of balances to 150 customers. The differences disclosed in confirmation replies were minor in amount and nature, and we reconciled them to our satisfaction. The results are summarized as follows:

	<u>Account Balance</u>	<u>Accounts Receivable Aging and Confirmation</u>	
		<u>Confirmation Results</u>	
		<u>Requested</u>	<u>Received</u>
Current .....	\$156,000	\$ 76,000	\$ 65,000
Past due:			
Less than one month .....	60,000	30,000	19,000
One to three months .....	36,000	18,000	10,000
Over three months .....	48,000	48,000	8,000
	<u>\$300,000</u>	<u>\$172,000</u>	<u>\$102,000</u>

Because the above procedures do not constitute an examination made in accordance with generally accepted auditing standards, we do not express an opinion on any of the accounts or items referred to above. In connection with the procedures referred to above, no matters came to our attention that caused us to believe that the specified accounts or items should be adjusted. Had we performed additional procedures or had we made an examination of the financial statements in accordance with generally accepted auditing standards, matters might have come to our attention that would have been reported to you. This report relates only to the accounts and items specified above and does not extend to any financial statements of Y Company, Inc., taken as a whole.

[Source: SAS No. 35, paragraph 6 (AU section 622.06).]

**.090 Claims of Creditors**

Trustee

XYZ Company

At your request, we have performed the procedures enumerated below with respect to the claims of creditors of XYZ Company as of May 31, 19XX, set forth in the accompanying schedules. Our review was made solely to assist you in evaluating the reasonableness of those claims, and our report is not to be used for any other purpose. The procedures we performed are summarized as follows:

- a. We compared the total of the trial balance of accounts payable at May 31, 19XX, prepared by the company, to the balance in the company's related general ledger account.
- b. We compared the claims received from creditors to the trial balance of accounts payable.
- c. We examined documentation submitted by the creditors in support of their claims and compared it to documentation in the company's files, including invoices, receiving records, and other evidence of receipt of goods or services.

Our findings are presented in the accompanying schedules. Schedule A lists claims that are in agreement with the company's records. Schedule B lists claims that are not in agreement with the company's records and sets forth the differences in amounts.

Because the above procedures do not constitute an examination made in accordance with generally accepted auditing standards, we do not express an opinion on the accounts payable balance as of May 31, 19XX. In connection with the procedures referred to above, except as set forth in Schedule B, no matters came to our attention that caused us to believe that the accounts payable balance might require adjustment. Had we performed additional procedures or had we made an examination of the financial statements in accordance with generally accepted auditing standards, other matters might have come to our attention that would have been reported to you. This report relates only to the accounts and items specified above and does not extend to any financial statements of XYZ Company, taken as a whole.

[Source: SAS No. 35, paragraph 6 (AU section 622.06).]



**.100 Compliance With Contractual Provisions (Separate Report)**

We have examined the balance sheet of XYZ Company as of December 31, 19X1, and the related statements of income, retained earnings, and changes in financial position for the year then ended, and have issued our report thereon dated February 16, 19X2. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In connection with our examination, nothing came to our attention that caused us to believe that the Company was not in compliance with any of the terms, covenants, provisions, or conditions of sections XX to XX, inclusive, of the Indenture dated July 21, 19X0, with ABC Bank. However, it should be noted that our examination was not directed primarily toward obtaining knowledge of such noncompliance.

[Source: SAS No. 14, paragraph 19 (AU section 621.19).]

**.110 Compliance With Contractual Provisions (Auditor's Report Accompanying Financial Statements)**

We have examined the balance sheet of XYZ Company as of December 31, 19X1, and the related statements of income, retained earnings, and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the financial statements referred to above present fairly the financial position of XYZ Company as of December 31, 19X1, and the results of its operations and changes in its financial position for the year then ended, in conformity with generally accepted accounting principles applied on a basis consistent with that of the preceding year.

In connection with our examination, nothing came to our attention that caused us to believe that the Company was not in compliance with any of the terms, covenants, provisions, or conditions of sections XX to XX, inclusive, of the Indenture dated July 21, 19X0, with ABC Bank. However, it should be noted that our examination was not directed primarily toward obtaining knowledge of such noncompliance.

[Source: SAS No. 14, paragraph 19 (AU section 621.19).]

**.120 Compliance With Regulatory Requirements**

We have examined the balance sheet of XYZ Company as of December 31, 19X1, and the related statements of income, retained earnings, and changes in financial position for the year then ended, and have issued our report thereon dated March 5, 19X2. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In connection with our examination, nothing came to our attention that caused us to believe that the Company had failed to comply with the limitation and increased investment requirement in section 993(d)(2) and (3) of the Internal Revenue Code of 1954. However, it should be noted that our examination was not directed primarily toward obtaining knowledge of noncompliance with such requirements.

[Source: SAS No. 14, paragraph 19 (AU section 621.19).]

**.130 Special Purpose Financial Statements Prepared Pursuant to a Loan Agreement—Effects of Departures from Generally Accepted Accounting Principles Disclosed in a Note to the Statements**

We have examined the special-purpose balance sheet of ABC Company as of December 31, 19X1, and the related special-purpose statements of income, retained earnings, and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The accompanying special-purpose financial statements have been prepared for the purpose of complying with, and on the basis of accounting practices specified in, section 4 of a loan agreement between DEF Bank and the Company dated (date). These practices differ, as described in Note X, from generally accepted accounting principles. Accordingly, the financial statements are not intended to present and, in our opinion, do not present fairly the financial position, results of operations and changes in financial position of ABC Company in conformity with generally accepted accounting principles.

In our opinion, however, the accompanying special-purpose financial statements of ABC Company are presented fairly on the basis of accounting described in Note X, which basis has been applied in a manner consistent with that of the preceding year.

[Source: Interpretation No. 5 of SAS No. 14 (AU section 9621.25).]

**.131 Special Purpose Financial Statements Prepared Pursuant to a Loan Agreement—Effects of Departures From Generally Accepted Accounting Principles Disclosed by Referring to Coexisting Audited Financial Statements**

We have examined the special-purpose balance sheet of ABC Company as of December 31, 19X1, and the related special-purpose statements of income, retained earnings, and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The accompanying special-purpose financial statements have been prepared for the purpose of complying with, and on the basis of accounting practices specified in, section 4 of a loan agreement between DEF Bank and the Company dated (date). These practices differ, as described in Note X, from generally accepted accounting principles. Accordingly, the financial statements are not intended to present and, in our opinion, do not present fairly the financial position, results of operations and changes in financial position of ABC Company in conformity with generally accepted accounting principles. The monetary effects of the departures from generally accepted accounting principles can be determined by comparing the special-purpose financial statements with the financial statements of ABC Company for the year ended December 31, 19X1, prepared in conformity with generally accepted accounting principles on which we issued our report dated February 14, 19X2.

In our opinion, however, the accompanying special-purpose financial statements of ABC Company are presented fairly on the basis of accounting described in Note X, which basis has been applied in a manner consistent with that of the preceding year.

[Source: Interpretation No. 5 of SAS No. 14 (AU section 9621.25).]

**.132 Special Purpose Financial Statements Prepared Pursuant to an Acquisition Agreement—  
Effects of Departures From Generally Accepted Accounting Principles Have Not Been  
Determined**

We have examined the special-purpose balance sheet of ABC Company as of June 30, 19XX, and the related special-purpose statements of income, retained earnings, and changes in financial position for the year then ended. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The accompanying special-purpose financial statements have been prepared for the purpose of complying with, and on the basis of accounting practices, specified in, an acquisition agreement dated May 15, 19XX, between ABC Company and DEF Company. These practices differ, as described in Note X, from generally accepted accounting principles; the monetary effects on the accompanying financial statements of such differences have not been determined. Accordingly, we are unable to and do not express an opinion on whether the accompanying special-purpose financial statements fairly present the financial position, results of operations and changes in financial position of ABC Company in conformity with generally accepted accounting principles.

In our opinion, however, the accompanying special-purpose financial statements of ABC Company are presented fairly on the basis of accounting described in Note X.

[Source: Interpretation No. 5 of SAS No. 14 (AU section 9621.25).]

**.140 Special Purpose Financial Presentation—Schedule of Gross Income and Certain Expenses**

We have examined the accompanying Historical Summary of Gross Income and Direct Operating Expenses of ABC Apartments, City, State, for each of the three years in the period ended December 31, 19XX. Our examinations were made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The accompanying historical summary was prepared for the purpose of complying with the rules and regulations of the Securities and Exchange Commission (for inclusion in the registration statement on Form S-11 of DEF Corporation) and excludes certain material expenses, described in Note X, that would not be comparable to those resulting from the proposed future operations of the property.

In our opinion, the historical summary referred to above presents fairly the gross income and direct operating expenses described in Note X of ABC Apartments for each of the three years in the period ended December 31, 19XX, in conformity with generally accepted accounting principles applied on a consistent basis.

[Source: Interpretation No. 6 of SAS No. 14 (AU section 9621.31).]

**.141 Special Purpose Financial Presentation—Statement of Assets Sold and Liabilities Transferred**

We have examined the statement of net assets of ABC Company as of June 8, 19XX, sold pursuant to the Purchase Agreement as described in Note X, between ABC Company and XYZ Corporation dated May 8, 19XX. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

In our opinion, the accompanying statement presents fairly the net assets of ABC Company as of June 8, 19XX, sold pursuant to the purchase agreement referred to above, in conformity with generally accepted accounting principles.

[Source: Interpretation No. 6 of SAS No. 14 (AU section 9621.31).]



**.150 Report on the Application of Accounting Principles****Introduction**

We have been engaged to report on the appropriate application of generally accepted accounting principles to the specific (hypothetical) transaction described below. This report is being issued to the ABC Company (XYZ Intermediaries) for assistance in evaluating accounting principles for the described specific (hypothetical) transaction. Our engagement has been conducted in accordance with standards established by the American Institute of Certified Public Accountants.

**Description of Transaction**

The facts, circumstances, and assumptions relevant to the specific (hypothetical) transaction as provided to us by the management of ABC Company (XYZ Intermediaries) are as follows:

Prior to 19X1, ABC Company used the accelerated cost recovery method (ACRS) to depreciate fixed assets for financial reporting and income tax purposes. The number of years specified by ACRS for recovery deductions of the fixed assets did not fall within a reasonable range of the asset's useful life. ABC Company switched to the straight-line method of depreciating its fixed assets in the current year.

**Appropriate Accounting Principles**

The change in depreciation methods should be accounted for as a prior period adjustment in the current year's financial statements in accordance with FASB Statement No. 16, *Prior Period Adjustments*, paragraph 11 [AC A35.103]. Since the number of years specified by ACRS for recovery deductions of the fixed assets did not fall within a reasonable range of the asset's useful life, the ACRS method would not be considered a generally accepted accounting principle. According to APB Opinion 20, *Accounting Changes*, paragraph 13 [AC A35.104], "A change from an accounting principle that is not generally accepted to one that is generally accepted is a correction of an error for purposes of applying this Opinion."

**Concluding Comments**

The ultimate responsibility for the decision on the appropriate applications of generally accepted accounting principles for an actual transaction rests with the preparers of financial statements, who should consult with their continuing accountants. Our judgment on the appropriate application of generally accepted accounting principles for the described specific (hypothetical) transaction is based solely on the facts provided to us as described above; should these facts and circumstances differ, our conclusion may change.

[Source: SAS No. 50, paragraph 9 (AU section 625.09).]

---

[The next page is 10,571.]

# AAM Section 10,270

## *Unaudited Financial Statements of a Public Entity*

### .01 Disclaimer

The accompanying balance sheet of X Company as of December 31, 19X1, and the related statements of income, retained earnings, and cash flows for the year then ended were not audited by us, and, accordingly, we do not express an opinion on them.

(Signature and date)

[Source: SAS No. 26, paragraph 5 (AU section 504.05).]

---

#### NOTES:

- The disclaimer may accompany the unaudited financial statements or it may be placed directly on them. In addition, each page of the financial statements should be clearly and conspicuously marked as unaudited.
- If the unaudited financial statements are those of a privately held (nonpublic) company, this example is not appropriate. See AAM sections 10,400 and 10,500.

**.02 Current Period Financial Statements Unaudited—Prior Period Financial Statements Audited**

The accompanying balance sheet of ABC Company as of December 31, 19X2, and the related statements of income, retained earnings, and cash flows for the year then ended were not audited by us and, accordingly, we do not express an opinion on them.

The financial statements for the year ended December 31, 19X1, were audited by us (other accountants) and we (they) expressed an unqualified opinion on them in our (their) report dated March 1, 19X2, but we (they) have not performed any auditing procedures since that date.

[Source: SAS No. 26, paragraph 16 (AU section 504.16).]

---

**NOTES:**

- The disclaimer may accompany the unaudited financial statements or it may be placed directly on them. In addition, each page of the financial statements should be clearly and conspicuously marked as unaudited.
- If the unaudited financial statements are those of a privately held (nonpublic) company, this example is not appropriate. See AAM sections 10,400 and 10,500.

**.03 Disclaimer—Cash Basis Statements**

The accompanying statement of assets and liabilities resulting from cash transactions of XYZ Corporation as of December 31, 19X1, and the related statement of revenues collected and expenses paid during the year then ended were not audited by us and, accordingly, we do not express an opinion on them.

(Signature and date)

[Source: SAS No. 26, paragraph 7 (AU section 504.07).]

---

**NOTES:**

- A note to the financial statements should describe how the basis of presentation differs from generally accepted accounting principles, but the monetary effect of such differences need not be stated.
- The disclaimer may accompany the unaudited financial statements or it may be placed directly on them. In addition, each page of the financial statements should be clearly and conspicuously marked as unaudited.

**.04 Disclaimer—Regulatory (Statutory) Basis Statements**

The accompanying statement of admitted assets, liabilities, and surplus (statutory basis) of XYZ Insurance Company as of December 31, 19XX, and the related statements of income (statutory basis) and changes in surplus (statutory basis) for the year then ended were not audited by us and, accordingly, we do not express an opinion on them.

(Signature and date)

---

**NOTES:**

- A note to the financial statements should describe how the basis of presentation differs from generally accepted accounting principles, but the monetary effect of such differences need not be stated.
- The disclaimer may accompany the unaudited financial statements or it may be placed directly on them. In addition, each page of the financial statements should be clearly and conspicuously marked as unaudited.
- The above sample report was prepared to illustrate matters presented in SAS No. 26, paragraph 7 (AU section 504.07).

---

[The next page is 10,621.]

# AAM Section 10,280

## *Lack of Independence*

### .01 Disclaimer

We are not independent with respect to XYZ Company, and the accompanying balance sheet as of December 31, 19X1, and the related statements of income, retained earnings, and cash flows for the year then ended were not audited by us and, accordingly, we do not express an opinion on them.

[Source: SAS No. 26, paragraph 10 (AU section 504.10).]

---

#### NOTES:

- When an accountant is not independent, any procedures he might perform would not be in accordance with generally accepted auditing standards and he would be precluded from expressing an opinion on the financial statements. Accordingly, he would disclaim an opinion with respect to the financial statements and state specifically that he is not independent. The accountant should not include in his disclaimer the reasons for the lack of independence or any description of the procedures he has performed; including such matters might confuse readers concerning the importance of the lack of independence.
  - If the statements are those of a nonpublic entity, see SSARS No. 1, paragraphs 22 and 38 (AR section 100.22 and .38). See AAM sections 10,400 and 10,500.
- 

[The next page is 10,671.]



# AAM Section 10,300

## *Review of Interim Financial Information*

### .01 Accountant's Report

We have made a review of (describe the information or statements reviewed) of ABC Company and consolidated subsidiaries as of September 30, 19X1 and for the three-month and nine-month periods then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A review of interim financial information consists principally of obtaining an understanding of the system for the preparation of interim financial information, applying analytical review procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial (information or statements) for them to be in conformity with generally accepted accounting principles.

[Source: SAS No. 36, paragraph 18 (AU section 722.18).]

---

#### NOTE:

SAS No. 36, *Review of Interim Financial Information* (AU section 722), applies to reviews of interim financial information presented alone of a publicly-traded company; for this purpose the term interim includes financial statements or information of a twelve-month period ending on a date other than the company's normal year-end.



**.02 Accountant's Report—Comparative**

We have made a review of (describe the information or statements reviewed) of ABC Company and consolidated subsidiaries as of September 30, 19X1 and 19X0 and for the three-month and nine-month periods then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A review of interim financial information consists principally of obtaining an understanding of the system for the preparation of interim financial information, applying analytical review procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the accompanying financial (information or statements) for them to be in conformity with generally accepted accounting principles.

[Source: SAS No. 36, paragraph 18 (AU section 722.18).]

---

**NOTE:**

SAS No. 36, *Review of Interim Financial Information* (AU section 722), applies to reviews of interim financial information presented alone of a publicly-traded company; for this purpose the term interim includes financial statements or information of a twelve-month period ending on a date other than the company's normal year-end.

**.03 Reference to Other Accountants.**

We have made a review of (describe the information or statements reviewed) of ABC Company and consolidated subsidiaries as of September 30, 19X1, and for the three-month and nine-month periods then ended, in accordance with standards established by the American Institute of Certified Public Accountants. We were furnished with the report of other accountants on their review of the interim financial information of the ADE subsidiary, whose total assets and revenues constitute 20 percent and 22 percent, respectively, of the related consolidated totals.

A review of interim financial information consists principally of obtaining an understanding of the system for the preparation of interim financial information, applying analytical review procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review and the report of other accountants, we are not aware of any material modifications that should be made to the accompanying financial (information or statements) for them to be in conformity with generally accepted accounting principles.

[Source: SAS No. 36, paragraph 19 (AU section 722.19).]

---

**NOTE:**

SAS No. 36, *Review of Interim Financial Information* (AU section 722), applies to reviews of interim financial information presented alone of a publicly-traded company; for this purpose the term interim includes financial statements or information of a twelve-month period ending on a date other than the company's normal year-end.

**.04 Departure From GAAP**

We have made a review of (describe the information or statements reviewed) of ABC Company and consolidated subsidiaries as of September 30, 19X1 and for the three-month and nine-month periods then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A review of interim financial information consists principally of obtaining an understanding of the system for the preparation of interim financial information, applying analytical review procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on information furnished us by management, we believe that the Company has excluded from property and debt in the accompanying balance sheet certain lease obligations that should be capitalized in order to conform with generally accepted accounting principles. This information indicates that if these lease obligations were capitalized at September 30, 19X1, property would be increased by \$\_\_\_, and long-term debt by \$\_\_\_, and net income and earnings per share would be increased (decreased) by \$\_\_\_, \$\_\_\_, \$\_\_\_, and \$\_\_\_, respectively, for the three-month and nine-month periods then ended.

(Concluding paragraph)

Based on our review, with the exception of the matter(s) described in the preceding paragraph(s), we are not aware of any material modifications that should be made to the accompanying financial (information or statements) for them to be in conformity with generally accepted accounting principles.

[Source: SAS No. 36, paragraph 21 (AU section 722.21).]

---

**NOTE:**

SAS No. 36, *Review of Interim Financial Information* (AU section 722), applies to reviews of interim financial information presented alone of a publicly-traded company; for this purpose the term interim includes financial statements or information of a twelve-month period ending on a date other than the company's normal year-end.

**.05 Inadequate Disclosure**

We have made a review of (describe the information or statements reviewed) of ABC Company and consolidated subsidiaries as of September 30, 19X1 and for the three-month and nine-month periods then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A review of interim financial information consists principally of obtaining an understanding of the system for the preparation of interim financial information, applying analytical review procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Management has informed us that the Company is presently contesting deficiencies in federal income taxes proposed by the Internal Revenue Service for the years 19XX through 19XY in the aggregate amount of approximately \$\_\_\_\_\_, and that the extent of the Company's liability, if any, and the effect on the accompanying (information or statements) are not determinable at this time. The (information or statements) fail to disclose these matters, which we believe are required to be disclosed in conformity with generally accepted accounting principles.

(Concluding paragraph)

Based on our review, with the exception of the matter(s) described in the preceding paragraph(s), we are not aware of any material modifications that should be made to the accompanying financial (information or statements) for them to be in conformity with generally accepted accounting principles.

[Source: SAS No. 36, paragraph 22 (AU section 722.22).]

---

**NOTE:**

SAS No. 36, *Review of Interim Financial Information* (AU section 722), applies to reviews of interim financial information presented alone of a publicly-traded company; for this purpose the term interim includes financial statements or information of a twelve-month period ending on a date other than the company's normal year-end.

**.06 Restricted Scope of Review Stated in an Auditor's Report****Independent Auditor's Report**

We have audited the accompanying balance sheets of X Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended. These financial statements are the responsibility of the Company's management. Our responsibility is to express an opinion on these financial statements based on our audits.

We conducted our audits in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audits provide a reasonable basis for our opinion.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of X Company as of [at] December 31, 19X2 and 19X1, and the results of its operations and its cash flows for the years then ended in conformity with generally accepted accounting principles.

The selected quarterly financial data on page XX contain information that we did not audit and, accordingly, we do not express an opinion on that data. We attempted but were unable to review the quarterly data in accordance with standards established by the American Institute of Certified Public Accountants because we believe that the Company's system for preparing interim financial information does not provide an adequate basis to enable us to complete such a review.

[Signature]

[Date]

[Source: SAS No. 36, paragraph 29 (AU section 722.29).]

---

NOTE:

See, SAS No. 36, *Review of Interim Financial Information*, paragraphs 24—30 (AU section 722.24—.30), for guidance on reporting on interim financial information accompanying audited financial statements.

---

[The next page is 10,721.]

## AAM Section 10,400

# ***Accountant's Report on Compilation of Financial Statements of a Nonpublic Entity***

### **.01 Accountant's Standard Report**

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

[Source: SSARS 1, paragraph 17, as amended by SSARS 5, paragraph 2 (AR section 100.17, as amended by AR section 500.02).]

---

#### **NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.02 Omission of Substantially All Disclosures**

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

Management has elected to omit substantially all of the disclosures required by generally accepted accounting principles. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and the cash flows. Accordingly, these financial statements are not designed for those who are not informed about such matters.

[Source: SSARS 1, paragraph 21, as amended by SSARS 5, paragraph 2 (AR section 100.21, as amended by AR section 500.02).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

This form of report is appropriate only for a compilation engagement, not for a review engagement.

**.03 Omission of Statement of Cash Flows and Substantially All Disclosures**

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income and retained earnings for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

Management has elected to omit substantially all of the disclosures and the statement of cash flows required by generally accepted accounting principles. If the omitted disclosures and the statement of cash flows were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and its cash flows. Accordingly, these financial statements are not designed for those who are not informed about such matters.

[Source: SSARS 1, paragraph 21, as amended by SSARS 5, paragraph 2 (AR section 100.21, as amended by AR section 500.02).]

---

**NOTES:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

This form of report is appropriate only for a compilation engagement, not for a review engagement.



**.04 Accountant Not Independent**

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

I am (we are) not independent with respect to XYZ Company.<sup>1</sup>

[Sources: SSARS 1, paragraph 17, as amended by SSARS 5, paragraph 2 (AR section 100.17, as amended by AR section 500.02) and SSARS 1, paragraph 22 (AR section 100.22).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

---

<sup>1</sup> In making a judgment about whether he is independent, the accountant should be guided by the AICPA Code of Professional Conduct. For example, the accountant should be aware that interpretation 101-3 (ET section 101.05) under rule 101 (ET section 101.01) of the rules of conduct indicates that independence is not necessarily impaired when an accountant provides manual or automated bookkeeping or data processing services to a client.

**.05 Departure From GAAP—Omission of Statement of Cash Flows**

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income and retained earnings for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them. However, I (we) did become aware of a departure from generally accepted accounting principles that is described in the following paragraph.

A statement of cash flows for the year ended December 31, 19XX, has not been presented. Generally accepted accounting principles require that such a statement be presented when financial statements purport to present financial position and results of operations.

[Source: SSARS 1, paragraph 40, as amended by SSARS 5, paragraph 2 (AR section 100.40, as amended by AR section 500.02).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.06 Departure From GAAP—Accounting Principles Not Generally Accepted**

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them. However, I (we) did become aware of a departure (certain departures) from generally accepted accounting principles that is (are) described in the following paragraph.

As disclosed in note X to the financial statements, generally accepted accounting principles require that land be stated at cost. Management has informed me (us) that the company has stated its land at appraised value and that, if generally accepted accounting principles had been followed, the land account and stockholders' equity would have been decreased by \$500,000.

[Source: SSARS 1, paragraph 40, as amended by SSARS 5, paragraph 2 (AR section 100.40, as amended by AR section 500.02).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.07 Cash Basis Statements\*—Full Disclosure**

I (We) have compiled the accompanying statement of assets and liabilities arising from cash transactions of XYZ Company as of December 31, 19XX, and the related statement of revenue collected and expenses paid for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

[Source: Accounting and Review Services Interpretation No. 12 of SSARS 1 (AR section 9100.45).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

---

\*When financial statements are prepared in accordance with a comprehensive basis of accounting other than generally accepted accounting principles, the notes ordinarily would state the basis of presentation and describe how that basis differs from generally accepted accounting principles. [Source: Accounting and Review Services Interpretation No. 12 of SSARS No. 1 (AR section 9100.45).]

**.08 Cash Basis Statements—Omission of Substantially All Disclosures**

I (We) have compiled the accompanying statement of assets and liabilities arising from cash transactions of XYZ Company as of December 31, 19X4, and the related statement of revenue collected and expenses paid for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. The financial statements have been prepared on the cash basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

Management has elected to omit substantially all of the informative disclosures ordinarily included in financial statements. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the Company's assets, liabilities, equity, revenue and expenses. Accordingly, these financial statements are not designed for those who are not informed about such matters.

[Source: Accounting and Review Services Interpretation No. 12 of SSARS 1 (AR section 9100.45).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.09 Income Tax Basis Statements\*—Full Disclosure**

I (We) have compiled the accompanying statement of assets, liabilities, and capital—income tax basis of ABC Partnership as of December 31, 19XX, and the related statements of revenue and expenses—income tax basis and of changes in partners' capital accounts—income tax basis for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

---

\* When financial statements are prepared in accordance with a comprehensive basis of accounting other than generally accepted accounting principles, the notes ordinarily would state the basis of presentation and describe how that basis differs from generally accepted accounting principles. [Source: Accounting and Review Services Interpretation No. 12 of SSARS 1 (AR section 9100.45).]

**.10 Income Tax Basis Statements—Omission of Substantially All Disclosures, With No Reference to Basis**

I (We) have compiled the accompanying statement of assets, liabilities, and equity—income tax basis of XYZ Company as of December 31, 19XX, and the related statement of revenue and expenses—income tax basis for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. The financial statements have been prepared on the accounting basis used by the Company for Federal income tax purposes, which is a comprehensive basis of accounting other than generally accepted accounting principles.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

Management has elected to omit substantially all of the disclosures ordinarily included in financial statements prepared on the income tax basis of accounting. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the Company's assets, liabilities, equity, revenue and expenses. Accordingly, these financial statements are not designed for those who are not informed about such matters.

[Source: Accounting and Review Services Interpretation No. 12 of SSARS 1 (AR section 9100.45).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.11 Compilation Each Period—Comparative Financial Statements**

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

[Source: SSARS 2, paragraph 9, as amended by SSARS 5, paragraph 2 (AR section 200.09, as amended by AR section 500.02).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.



**.12 Compilation Report on Current Period and Reference to Review Report on Prior Period—  
Comparative Financial Statements**

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 19X2, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying 19X2 financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

The accompanying 19X1 financial statements of XYZ Company were previously reviewed by me (us) and my (our) report dated March 1, 19X2, stated that I was (we were) not aware of any material modifications that should be made to those statements in order for them to be in conformity with generally accepted accounting principles. I (we) have not performed any procedures in connection with that review engagement after the date of my (our) report on the 19X1 financial statements.

[Sources: SSARS 2, paragraph 12 (AR section 200.12) and SSARS 1, paragraph 17, as amended by SSARS 5, paragraph 2 (AR section 100.17, as amended by AR section 500.02).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.13 Changed Reference to a Departure From Generally Accepted Accounting Principles<sup>2</sup>—Comparative Financial Statements**

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

In my (our) previous compilation report dated March 1, 19X2, on the 19X1 financial statements, I (we) referred to a departure from generally accepted accounting principles because the company carried its land at appraised values. However, as disclosed in Note X, the company has restated its 19X1 financial statements to reflect its land at cost in accordance with generally accepted accounting principles.

[Sources: SSARS 2, paragraph 15 (AR section 200.15) and SSARS 1, paragraph 17, as amended by SSARS 5, paragraph 2 (AR section 100.17, as amended by AR section 500.02).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

---

<sup>2</sup> A changed reference to a departure from generally accepted accounting principles includes the removal of a prior reference or the inclusion of a new reference.

**.14 Predecessor's Compilation Report on Prior Period Not Presented—Comparative Financial Statements**

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 19X2, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying 19X2 financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

The 19X1 financial statements of XYZ Company were compiled by other accountants whose report dated February 1, 19X2, stated that they did not express an opinion or any other form of assurance on those statements.

[Sources: SSARS 2, paragraph 19, as amended by SSARS 5, paragraph 2 (AR section 200.19, as amended by AR section 500.02) and SSARS 1, paragraph 17, as amended by SSARS 5, paragraph 2 (AR section 100.17, as amended by AR section 500.02).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.15 Predecessor's Review Report on Prior Period Not Presented—Comparative Financial Statements**

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 19X2, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying 19X2 financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

The 19X1 financial statements of XYZ Company were reviewed by other accountants whose report dated March 1, 19X2, stated that they were not aware of any material modifications that should be made to those statements in order for them to be in conformity with generally accepted accounting principles.

[Sources: SSARS 2, paragraph 18 (AR section 200.18) and SSARS 1, paragraph 17, as amended by SSARS 5, paragraph 2 (AR section 100.17, as amended by AR section 500.02).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.16 Prior Period Audited—Comparative Financial Statements**

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 19X2, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying 19X2 financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

The financial statements for the year ended December 31, 19X1, were examined by me (us) (other accountants) and I (we) (they) expressed an unqualified opinion on them in my (our) (their) report dated March 1, 19X2, but I (we) (they) have not performed any auditing procedures since that date.

[Sources: SSARS 2, paragraph 28 (AR section 200.28) and SSARS 1, paragraph 17, as amended by SSARS 5, paragraph 2 (AR section 100.17, as amended by AR section 500.02).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.17 Omission of Substantially All Disclosures Including Those for Prior Period Previously Not Omitted—Comparative Financial Statements**

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

Management has elected to omit substantially all of the disclosures required by generally accepted accounting principles. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the company's financial position, results of operations, and its cash flows. Accordingly, these financial statements are not designed for those who are not informed about such matters.

The accompanying 19X1 financial statements were compiled by me (us) from financial statements that did not omit substantially all of the disclosures required by generally accepted accounting principles and that I (we) previously compiled (reviewed) as indicated in my (our) report dated March 1, 19X2.

[Source: SSARS 2, paragraph 30, as amended by SSARS 5, paragraph 2 (AR section 200.30, as amended by AR section 500.02).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.18 Financial Statements Accompanied by Supplementary Information**

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the year then ended, and the accompanying (identify the supplementary information, for example, schedules of cost of goods sold and selling, general and administrative expenses, which are presented only for supplementary analysis purposes, in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements and supplementary schedules information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and supplementary schedules and, accordingly, do not express an opinion or any other form of assurance on them.

[Source: SSARS 1, paragraph 43 (AR section 100.43).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.19 Financial Statements Included in Certain Prescribed Forms**

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the year then ended included in the accompanying prescribed form, in accordance with standards established by the American Institute of Certified Public Accountants.

My (our) compilation was limited to presenting in the form prescribed by ABC Bank information that is the representation of management (owners). I (we) have not audited or reviewed the financial statements referred to above and, accordingly, do not express an opinion or any other form of assurance on them.

These financial statements (including related disclosures) are presented in accordance with the requirements of ABC Bank, which differ from generally accepted accounting principles. Accordingly, these financial statements are not designed for those who are not informed about such differences.

[Source: SSARS 3, paragraph 3, as amended by SSARS 5, paragraph 2 (AR section 300.03), as amended by AR section 500.02).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity. SSARS 3 (AR section 300), provides for an alternative form of standard compilation report when a prescribed form or related instructions call for departure from generally accepted accounting principles or another comprehensive basis of accounting.



**.20 Financial Statements Included in Certain Prescribed Forms—Departure from GAAP Not Called for by the Prescribed Forms**

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the year then ended included in the accompanying prescribed form, in accordance with standards established by the American Institute of Certified Public Accountants.

My (our) compilation was limited to presenting in the form prescribed by ABC Trade Association information that is the representation of management (owners). I (we) have not audited or reviewed the financial statements referred to above and, accordingly, do not express an opinion or any other form of assurance on them. However, I (we) did become aware of a departure from generally accepted accounting principles that is not called for by the prescribed form or related instructions, as described in the following paragraph.

As disclosed in note X to the financial statements, generally accepted accounting principles require that land be stated at cost. Management has informed me (us) that the company has stated its land at appraised value and that, if generally accepted accounting principles have been followed, the land account and stockholders' equity would have been decreased by \$500,000.

These financial statements (including related disclosures) are otherwise presented in accordance with the requirements of ABC Trade Association, which also differ from generally accepted accounting principles. Accordingly, these financial statements are not designed for those who are not informed about such differences.

[Source: SSARS 3, paragraph 4 (AR section 300.04).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity. SSARS 3 (AR section 300), provides for an alternative form of standard compilation report when a prescribed form or related instructions call for departure from generally accepted accounting principles or another comprehensive basis of accounting.

**.21 Uncertainty With Note Disclosure—Entity's Continued Existence ("Going Concern")**

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

As discussed in Note X, certain conditions indicate that the Company may be unable to continue in existence. The accompanying financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence.\*

[Sources: SSARS 1, paragraph 40 (AR section 100.40) and Accounting and Review Services Interpretation No. 11 of SSARS 1 (AR section 100.40 and AR section 9100.38).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

---

\* Although not a requirement, an accountant may wish to draw attention to an uncertainty in an explanatory paragraph of his compilation report.

**.22 Interim Financial Statements Accompanied by a Financial Forecast Labeled as a "Budget"**

I (We) have compiled the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the six months then ending, in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

The accompanying budgeted balance sheet, statements of income, retained earnings, and cash flows of XYZ Company as of December 31, 19XX, and for the six months then ending, have not been compiled or examined by us and, accordingly, we do not express an opinion or any other form of assurance on them.

Management (owners) has (have) elected to omit the summaries of significant assumptions and accounting policies required under established guidelines for presentation of prospective financial statements. If the omitted summaries were included in the budgeted information, they might influence the user's conclusions about the company's budgeted information. Accordingly, this budgeted information is not designed for those who are not informed about such matters.

[Source: SSARS 1, paragraph 17 (AR section 100.17) and Statement on Standards for Accountants' Services on Prospective Financial Information, *Financial Forecasts and Projections*, paragraph 58 (AU section 2100.58).]

**.23 Interim Financial Statements Accompanied by a Financial Forecast Labeled as an "Annual Budget"**

I (We) have compiled the accompanying balance sheet of XYZ Company as of June 30, 19XX, and the related statements of income, retained earnings, and cash flows for the six month period then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

The accompanying annual budget of XYZ Company for the year ending December 31, 19XX has not been compiled or examined by us and, accordingly, we do not express an opinion or any other form of assurance on it.

Management (owners) has (have) elected to omit the summaries of significant assumptions and accounting policies required under established guidelines for presentation of prospective financial statements. If the omitted summaries were included in the budgeted information, they might influence the user's conclusions about the company's budgeted information. Accordingly, this budgeted information is not designed for those who are not informed about such matters.

[Source: SSARS 1, paragraph 17 (AR section 100.17) and Statement on Standards for Accountants' Services on Prospective Financial Information, *Financial Forecasts and Projections*, paragraph 58 (AU section 2100.58).]

---

[The next page is 10,771.]



## AAM Section 10,500

# *Accountant's Report on Review of Financial Statements of a Nonpublic Entity*

### .01 Accountant's Standard Report

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

[Source: SSARS 1, paragraph 35 (AR section 100.35).]

---

#### NOTE:

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.02 Departure From GAAP—Accounting Principle Not Generally Accepted**

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, with the exception of the matter described in the following paragraph, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

As disclosed in note X to the financial statements, generally accepted accounting principles require that inventory cost consist of material, labor, and overhead. Management has informed me (us) that the inventory of finished goods and work in process is stated in the accompanying financial statements at material and labor cost only, and that the effects of this departure from generally accepted accounting principles on financial position, results of operations, and cash flows have not been determined.

[Source: SSARS 1, paragraph 40 (AR section 100.40).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.03 Departure From GAAP—Change in Accounting Principle Without Reasonable Justification**

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, with the exception of the matter described in the following paragraph, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

As disclosed in note X to the financial statements, the company has adopted (description of newly adopted method), whereas it previously used (description of previous method). Although the (description of newly adopted method) is in conformity with generally accepted accounting principles, the company does not appear to have reasonable justification for making a change as required by Opinion No. 20 of the Accounting Principles Board.

[Source: SSARS 1, paragraph 40 (AR section 100.40).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.



**.04 Departure From GAAP—Omission of Statement of Cash Flows**

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, and retained earnings, for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, with the exception of the matter described in the following paragraph, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

A statement of cash flows for the year ended December 31, 19XX, has not been presented. Generally accepted accounting principles require that such a statement be presented when financial statements purport to present financial position and results of operations.

[Source: SSARS 1, paragraph 40 (AR section 100.40).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.05 Cash Basis Statements\*—Full Disclosure**

I (We) have reviewed the accompanying statement of assets and liabilities arising from cash transactions of XYZ Company as of December 31, 19XX, and the related statement of revenue collected and expenses paid for the year ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with the cash basis of accounting, as described in Note X.

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

---

\* When financial statements are prepared in accordance with a comprehensive basis of accounting other than generally accepted accounting principles, the notes ordinarily would state the basis of presentation and describe how that basis differs from generally accepted accounting principles. [Source: Accounting and Review Services Interpretation No. 12 of SSARS 1 (AR section 9100.41—.45).]

**.06 Income Tax Basis Statements\*—Full Disclosure**

I (We) have reviewed the accompanying statement of assets, liabilities, and equity—income tax basis of XYZ Company as of December 31, 19XX, and the related statement of revenue and expenses—income tax basis for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with the basis of accounting, as described in Note X.

[Source: Accounting and Review Services Interpretation No. 12 of SSARS 1 (AR section 9100.45).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

---

\* When financial statements are prepared in accordance with a comprehensive basis of accounting other than generally accepted accounting principles, the notes ordinarily would state the basis of presentation and describe how that basis differs from generally accepted accounting principles. [Source: Accounting and Review Services Interpretation No. 12 of SSARS 1 (AR section 9100.41—.45).]

**.07 Review Each Period—Comparative Financial Statements**

I (We) have reviewed the accompanying balance sheets of XYZ Company as of December 31, 19X2 and 19X1, and the related statements of income, retained earnings, and cash flows for the years then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) reviews, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

[Source: SSARS 2, paragraph 9 (AR section 200.09).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.08 Review Report on Current Period and Reference to Compilation Report on Prior Period—Comparative Financial Statements**

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19X2, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the 19X2 financial statements in order for them to be in conformity with generally accepted accounting principles.

The accompanying 19X1 financial statements of XYZ Company were compiled by me (us). A compilation is limited to presenting in the form of financial statements information that is the representation of management (owners). I (we) have not audited or reviewed the 19X1 financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

[Source: SSARS 2, paragraph 10 (AR section 200.10).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.09 Changed Reference to a Departure From Generally Accepted Accounting Principles<sup>1</sup>—Comparative Financial Statements**

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19X2 and 19X1, the related statements of income, retained earnings, and cash flows for the years then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

In my (our) previous review report dated March 1, 19X2, on the 19X1 financial statements, I (we) referred to a departure from generally accepted accounting principles because the company carried its land at appraised values. However, as disclosed in Note X, the company has restated its 19X1 financial statements to reflect its land in accordance with generally accepted accounting principles.

[Sources: SSARS 2, paragraph 15 (AR section 200.15) and SSARS 1, paragraph 35 (AR section 100.35).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

---

<sup>1</sup> A changed reference to a departure from generally accepted accounting principles includes the removal of a prior reference or the inclusion of a new reference.

**.10 Predecessor's Review Report on Prior Period Not Presented—Comparative Financial Statements**

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19X2, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying 19X2 financial statements in order for them to be in conformity with generally accepted accounting principles.

The 19X1 financial statements of XYZ Company were reviewed by other accountants whose report dated March 1, 19X2, stated that they were not aware of any material modifications that should be made to those statements in order for them to be in conformity with generally accepted accounting principles.

[Sources: SSARS 2, paragraph 18 (AR section 200.18) and SSARS 1, paragraph 35 (AR section 100.35).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.11 Predecessor's Compilation Report on Prior Period Not Presented—Comparative Financial Statements**

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19X2, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying 19X2 financial statements in order for them to be in conformity with generally accepted accounting principles.

The 19X1 financial statements of XYZ Company were compiled by other accountants whose report dated February 1, 19X2, stated that they did not express an opinion or any other form of assurance on those statements.

[Sources: SSARS 2, paragraph 19 (AR section 200.19) and SSARS 1, paragraph 35 (AR section 100.35).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.



**.12 Prior Period Audited—Comparative Financial Statements**

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19X2, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying 19X2 financial statements in order for them to be in conformity with generally accepted accounting principles.

The financial statements for the year ended December 31, 19X1, were audited by me (us) (other accountants) and I (we) (they) expressed an unqualified opinion on them in my (our) (their) report dated March 1, 19X2, but I (we) (they) have not performed any auditing procedures since that date.

[Sources: SSARS 2, paragraph 28 (AR section 200.28) and SSARS 1, paragraph 35 (AR section 100.35).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.13 Financial Statements Accompanied by Supplementary Information Subjected to Inquiry and Analytical Procedures**

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

My (our) review was made for the purpose of expressing limited assurance that there are no material modifications that should be made to the financial statements in order for them to be in conformity with generally accepted accounting principles. The information included in the accompanying (identify the supplementary information, for example, schedules of cost of goods sold and selling, general, and administrative expenses) is presented only for supplementary analysis purposes. Such information has been subjected to the inquiry and analytical procedures applied in the review of the basic financial statements and I am (we are) not aware of any material modifications that should be made thereto.

[Source: SSARS 1, paragraph 43 (AR section 100.43).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.14 Financial Statements Accompanied by Supplementary Information Not Subjected to Inquiry and Analytical Procedures**

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

My (our) review was made for the purpose of expressing limited assurance that there are no material modifications that should be made to the financial statements in order for them to be in conformity with generally accepted accounting principles. The information included in the accompanying (identify the supplementary information, for example, schedules of cost of goods sold and selling, general, and administrative expenses) is presented only for supplementary analysis purposes. Such information has not been subjected to the inquiry and analytical procedures applied in the review of the basic financial statements, but was compiled from information that is the representation of management, without audit or review. Accordingly, I (we) do not express an opinion or any other form of assurance on the supplementary information.

[Source: SSARS 1, paragraph 43 (AR section 100.43).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

**.15 Uncertainty With Note Disclosure—Entity's Continued Existence ("Going Concern")**

I (We) have reviewed the accompanying balance sheet of XYZ Company as of December 31, 19XX, and the related statements of income, retained earnings, and cash flows for the year then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of the management (owners) of XYZ Company.

A review consists principally of inquiries of company personnel and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

As discussed in Note X, certain conditions indicate that the Company may be unable to continue in existence. The accompanying financial statements do not include any adjustments relating to the recoverability and classification of recorded asset amounts or the amounts and classification of liabilities that might be necessary should the Company be unable to continue in existence.\*

[Sources: SSARS 1, paragraph 40 (AR section 100.40) and Accounting and Review Services Interpretation No. 11 of SSARS 1 (AR section 9100.38).]

---

**NOTE:**

Statements on Standards for Accounting and Review Services provide guidance to the accountant who performs services in connection with unaudited financial statements or other unaudited financial information of a nonpublic entity.

---

[The next page is 10,791.]

---

\* Although not a requirement, an accountant may wish to draw attention to an uncertainty in an explanatory paragraph of his review report.



# AAM Section 10,550

## *Accountant's Report on Condensed Financial Statements and Selected Financial Data*

### **.01 Unqualified Opinion on Condensed Financial Statements<sup>1</sup>**

We have audited, in accordance with generally accepted auditing standards, the consolidated balance sheet of X Company and subsidiaries as of December 31, 19X0, and the related consolidated statements of income, retained earnings, and cash flows for the year then ended (not presented herein); and in our report dated February 15, 19X1, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated financial statements is fairly stated in all material respects in relation to the consolidated financial statements from which it has been derived.

[Source: SAS No. 42, paragraph 6 (AU section 552.06).]

---

<sup>1</sup> This report is appropriate when reporting in a client-prepared document on condensed financial statements (either for an annual or an interim period) that are derived from audited financial statements of a public entity that is required to file, at least annually, complete audited financial statements with a regulatory agency (See SAS No. 42, paragraph 1a [AU section 552.016]).

**.02 Adverse Opinion on Condensed Financial Statements Due to Inadequate Disclosure<sup>2</sup>**

We have audited the consolidated balance sheet of X Company and subsidiaries as of December 31, 19X0, and the related consolidated statements of income, retained earnings, and cash flows for the year then ended (not presented herein). Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The condensed consolidated balance sheet as of December 31, 19X0, and the related condensed consolidated statements of income, retained earnings, and cash flows for the year then ended, presented on pages XX-XX, are presented as a summary and therefore do not include all of the disclosures required by generally accepted accounting principles.

In our opinion, because of the significance of the omission of the information referred to in the preceding paragraph, the condensed consolidated financial statements referred to above do not present fairly, in conformity with generally accepted accounting principles, the financial position of X Company and subsidiaries as of December 31, 19X0, or the results of their operations and their cash flows for the year then ended.

[Source: SAS No. 42, paragraph 7, footnote 6 (AU section 552.07).]

---

<sup>2</sup> If a statement naming the auditor and stating that condensed financial statements have been derived from audited financial statements is made in a client-prepared document that does not include audited financial statements and the client is not a public entity that is required to file complete audited financial statements with a regulatory agency at least annually, this report is appropriate (See SAS 42, paragraph 7, footnote 6 [AU section 552.07]).

**.03 Review Report on Condensed Financial Statements**

We have made a review of the condensed consolidated balance sheet of ABC Company and subsidiaries as of March 31, 19X1, and the related condensed consolidated statements of income and cash flows for the three-month periods ended March 31, 19X1 and 19X0, in accordance with standards established by the American Institute of Certified Public Accountants.

A review of interim financial information consists principally of obtaining an understanding of the system for the preparation of interim financial information, applying analytical procedures to financial data, and making inquiries of persons responsible for financial and accounting matters. It is substantially less in scope than an audit in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, we do not express such an opinion.

Based on our review, we are not aware of any material modifications that should be made to the condensed consolidated financial statements referred to above for them to be in conformity with generally accepted accounting principles.

We have previously audited, in accordance with generally accepted auditing standards, the consolidated balance sheet as of December 31, 19X0, and the related consolidated statements of income, retained earnings, and cash flows for the year then ended (not presented herein); and in our report dated February 15, 19X1, we expressed an unqualified opinion on those consolidated financial statements. In our opinion, the information set forth in the accompanying condensed consolidated balance sheet as of December 31, 19X0, is fairly stated in all material respects in relation to the consolidated balance sheet from which it has been derived.

[Source: SAS No. 42, paragraph 8 (AU section 552.08).]

---

[The next page is 10,851.]





# AAM Section 10,600

## *Reports on Personal Financial Statements*

### .01 Auditor's Standard Report

#### Independent Auditor's Report

I (We) have audited the statement of financial condition of James and Jane Person as of [date], and the related statement of changes in net worth for the [period] then ended. These financial statements are the responsibility of James and Jane Person. My (our) responsibility is to express an opinion on these financial statements based on my (our) audit.

I (We) conducted my (our) audit in accordance with generally accepted auditing standards. Those standards require that I (we) plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I (We) believe that my (our) audit provides a reasonable basis for my (our) opinion.

In my (our) opinion, the financial statements referred to above present fairly, in all material respects, the financial condition of James and Jane Person as of [date] and the changes in their net worth for the [period] then ended in conformity with generally accepted accounting principles.

[Signature]

[Date]

**.02 Audit Report—Statement of Financial Condition Only****Independent Auditor's Report**

I (We) have audited the statement of financial condition of James and Jane Person as of [date]. The financial statement is the responsibility of James and Jane Person. My (our) responsibility is to express an opinion on the financial statement based on my (our) audit.

I (we) conducted my (our) audit in accordance with generally accepted auditing standards. Those standards require that I (we) plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I (We) believe that my (our) audit provides a reasonable basis for my (our) opinion.

In my (our) opinion, the financial statement referred to above presents fairly, in all material respects, the financial condition of James and Jane Person as of [date] in conformity with generally accepted accounting principles.

[Signature]

[Date]

**.03 Audit Report—Departure from GAAP—Inappropriate Valuation Methods—Adverse Opinion****Independent Auditor's Report**

I (We) have audited the statement of financial condition of James and Jane Person as of [date], and the related statement of changes in net worth for the [period] then ended. These financial statements are the responsibility of James and Jane Person. My (our) responsibility is to express an opinion on these financial statements based on my (our) audit.

I (we) conducted my (our) audit in accordance with generally accepted auditing standards. Those standards require that I (we) plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I (we) believe that my (our) audit provides a reasonable basis for my (our) opinion.

As discussed in Note X to the financial statements, assets amounting to \$XX,XXX (XX percent of total assets) as of [date] have been valued at estimated current value as determined by James Person. I (we) have reviewed the procedures applied by James Person in valuing the assets and have inspected the underlying documentation. In my (our) opinion, those procedures are not appropriate to determine the estimated current values of the assets in conformity with generally accepted accounting principles. The effects on the financial statements of not applying appropriate procedures to determine the estimated current values of the assets are not reasonably determinable.

In my (our) opinion, because of the effects of the matters discussed in the preceding paragraph, the financial statements referred to above do not present fairly, in conformity with generally accepted accounting principles, the financial condition of James and Jane Person as of [date] and the changes in their net worth for the [period] then ended.

[Signature]

[Date]

**.04 Audit Report—Departure from GAAP—Inappropriate Valuation Methods—Qualified Opinion****Independent Auditor's Report**

I (We) have audited the statement of financial condition of James and Jane Person as of [date], and the related statement of changes in net worth for the [period] then ended. These financial statements are the responsibility of James and Jane Person. My (our) responsibility is to express an opinion on these financial statements based on my (our) audit.

I (we) conducted my (our) audit in accordance with generally accepted auditing standards. Those standards require that I (we) plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I (we) believe that my (our) audit provides a reasonable basis for my (our) opinion.

As discussed in Note X to the financial statements, assets amounting to \$XX,XXX (XX percent of total assets) as of [date] have been valued at estimated current value as determined by James Person. I (we) have reviewed the procedures applied by James Person in valuing the assets and have inspected the underlying documentation. In my (our) opinion, those procedures are not appropriate to determine the estimated current values of the assets in conformity with generally accepted accounting principles. The effects on the financial statements of not applying appropriate procedures to determine the estimated current values of the assets are not reasonably determinable.

In my (our) opinion, except for the effects on the financial statements of the valuation of assets determined by James Person, as described in the preceding paragraph, the financial statements referred to above present fairly, in all material respects, the financial condition of James and Jane Person as of [date] and the changes in their net worth for the [period] then ended in conformity with generally accepted accounting principles.

[Signature]

[Date]

**.05 Audit Report—Inadequate Records Preclude Opinion****Independent Auditor's Report**

I (We) was engaged to audit the statement of financial condition of James and Jane Person as of [date], and the related statement of changes in net worth for the [period] then ended. These financial statements are the responsibility of James and Jane Person.

James and Jane Person do not maintain accounting records sufficient to assure that all transactions are recorded. Accordingly, it was not practicable for me (us) to extend my (our) auditing procedures sufficiently to determine that all of their assets and liabilities and the changes in their net worth are recorded in the financial statements referred to above.

Because James and Jane Person do not maintain certain accounting records and supporting documentation, and because I was (we were) unable to apply adequate auditing procedures regarding the recording of transactions as noted in preceding paragraph, the scope of my (our) work was not sufficient to enable me (us) to express, and I (we) do not express, an opinion on the financial statements referred to above.

[Signature]

[Date]

**.06 Audit Report—Scope Limitation—Inadequate Records****Independent Auditor's Report**

I (We) have audited the statement of financial condition of James and Jane Person as of [date], and the related statement of changes in net worth for the [period] then ended. These financial statements are the responsibility of James and Jane Person. My (our) responsibility is to express an opinion on these financial statements based on my (our) audit.

Except as discussed in the following paragraph, I (we) conducted my (our) audit in accordance with generally accepted auditing standards. Those standards require that I (we) plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. I (we) believe that my (our) audit provides a reasonable basis for my (our) opinion.

James and Jane Person do not maintain accounting records sufficient to assure that all transactions are recorded. Accordingly, it was not practicable for me (us) to extend my (our) auditing procedures sufficiently to determine that all of their assets and liabilities and the changes in their net worth are recorded in the financial statements referred to above.

In my (our) opinion, except for the effects of such adjustments, if any, as might have been determined to be necessary had I (we) been able to determine that all assets and liabilities and changes in net worth were recorded in the financial statements, the financial statements referred to above present fairly, in all material respects, the financial condition of James and Jane Person as of [date], and the changes in their net worth for the [period] then ended, in conformity with generally accepted accounting principles.

[Signature]

[Date]

**.07 Audit Report—Income Tax Basis\***

I (we) have examined the statement of assets and liabilities—income tax basis of James and Jane Person as of [date], and the related statement of changes in net assets—income tax basis for the [period] then ended. My (our) examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as I (we) considered necessary in the circumstances.

As described in Note X to the financial statements, James and Jane Person prepare their financial statements on the accounting basis used for income tax purposes; consequently, certain income and related assets are recognized when received rather than when earned, certain expenses are recognized when paid rather than when the obligation is incurred, and assets and liabilities are presented on the basis of historical cost rather than estimated current values or amounts. Accordingly, the accompanying financial statements are not intended to present financial condition and changes in net worth in conformity with generally accepted accounting principles.

In my (our) opinion, the financial statements referred to above present fairly the assets and liabilities of James and Jane Person as of [date], and the changes in their net assets for the [period] then ended, on the basis of accounting described in Note X to the financial statements, which basis has been applied in a manner consistent with that of the preceding [period].

[Source: AICPA *Personal Financial Statements Guide*.]

---

\* Editor's Note: This report may be changed as a result of an exposure draft to conform SAS No. 14, *Special Reports* (AU section 621), to SAS No. 58, *Reports on Audited Financial Statements* (AU section 508). In the meantime, auditors should not adopt any SAS No. 58 language to report on OCBOA financial statements.



**.08 Accountant's Standard Compilation Report**

I (we) have compiled the accompanying statement of financial condition of James and Jane Person as of [date], and the related statement of changes in net worth for the [period] then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of the individuals whose financial statements are presented. I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

[Source: AICPA *Personal Financial Statements Guide*.]

**.09    Compilation Report—Statement of Financial Condition Only**

I (we) have compiled the accompanying statement of financial condition of James and Jane Person as of [date], in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of the individuals whose financial statements are presented. I (we) have not audited or reviewed the accompanying statement of financial condition and, accordingly, do not express an opinion or any other form of assurance on it.

[Source: AICPA *Personal Financial Statements Guide*.]

**.10 Compilation Report—Omission of Substantially All Disclosures**

I (we) have compiled the accompanying statement of financial condition of James and Jane Person as of [date], and the related statement of changes in net worth for the [period] then ended, in accordance with standards established by the American Institute of Certified Public Accountants.\*

A compilation is limited to presenting in the form of financial statements information that is the representation of the individuals whose financial statements are presented. I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

James and Jane Person have elected to omit substantially all of the disclosures required by generally accepted accounting principles. If the omitted disclosures were included in the financial statements, they might influence the user's conclusions about the financial condition of James and Jane Person and changes in their net worth. Accordingly, these financial statements are not designed for those who are not informed about such matters.

[Source: AICPA *Personal Financial Statements Guide*.]

---

\*Note: When personal financial statements omit substantially all disclosures and do not disclose that the assets are presented at their estimated current values and that the liabilities are presented at their estimated current amounts, the accountant should include the following sentence at the end of the first paragraph of his report:

The financial statements are intended to present the assets of James and Jane Person at estimated current values and their liabilities at estimated current amounts.

**.11 Compilation Report—GAAP Departure—Material Assets at Cost**

I (we) have compiled the accompanying statement of financial condition of James and Jane Person as of *[date]*, and the related statement of changes in net worth for the *[period]* then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of the individuals whose financial statements are presented. I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them. However, I (we) did become aware of a departure from generally accepted accounting principles that is described in the following paragraph.

As disclosed in Note X to the financial statements, generally accepted accounting principles require that assets be presented at their estimated current values and that liabilities be presented at their estimated current amounts. James and Jane Person have informed me (us) that their investment in ABC Company is stated in the accompanying financial statements at cost and that the effects of this departure from generally accepted accounting principles on their financial condition and the changes in their net worth have not been determined.

[Source: AICPA *Personal Financial Statements Guide*.]

**.12 Compilation Report—Income Tax Basis**

I (we) have compiled the accompanying statement of assets and liabilities—income tax basis of James and Jane Person as of [*date*], and the related statement of changes in net assets—income tax basis for the [*period*] then ended, in accordance with standards established by the American Institute of Certified Public Accountants.

A compilation is limited to presenting in the form of financial statements information that is the representation of the individuals whose financial statements are presented. I (we) have not audited or reviewed the accompanying financial statements and, accordingly, do not express an opinion or any other form of assurance on them.

[Source: AICPA *Personal Financial Statements Guide*.]

**.13 Compilation Report—Financial Statements Included in a Prescribed Form**

I (we) have compiled the [*identification of financial statements, including period covered and name of individual(s)*] included in the accompanying prescribed form, in accordance with standards established by the American Institute of Certified Public Accountants.

My (our) compilation was limited to presenting in the form prescribed by [*name of body*] information that is the representation of the individuals whose financial statements are presented. I (we) have not audited or reviewed the financial statements referred to above and, accordingly, do not express an opinion or any other form of assurance on them.

These financial statements (including related disclosures) are presented in accordance with the requirements of [*name of body*], which differ from generally accepted accounting principles. Accordingly, these financial statements are not designed for those who are not informed about such differences.

[Source: AICPA *Personal Financial Statements Guide*.]

**.14 Accountant's Standard Review Report**

I (we) have reviewed the accompanying statement of financial condition of James and Jane Person as of [date], and the related statement of changes in net worth for the [period] then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of James and Jane Person.

A review of personal financial statements consists principally of inquiries of the individuals whose financial statements are presented and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

[Source: AICPA *Personal Financial Statements Guide*.]

**.15 Review Report—Statement of Financial Condition Only**

I (we) have reviewed the accompanying statement of financial condition of James and Jane Person as of [date], in accordance with standards established by the American Institute of Certified Public Accountants. All information included in this financial statement is the representation of James and Jane Person.

A review of personal financial statements consists principally of inquiries of the individuals whose financial statements are presented and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying statement of financial condition in order for it to be in conformity with generally accepted accounting principles.

[Source: AICPA *Personal Financial Statements Guide*.]



**.16 Review Report—GAAP Departure—Failure to Include a Provision for Estimated Income Taxes on the Differences Between the Estimated Current Values of Assets and the Estimated Current Amounts of Liabilities and Their Tax Bases**

I (we) have reviewed the accompanying statement of financial condition of James Person as of [date], and the related statement of changes in net worth for the [period] then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of James Person.

A review of personal financial statements consists principally of inquiries of the individual whose financial statements are presented and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, with the exception of the matter described in the following paragraph, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with generally accepted accounting principles.

Generally accepted accounting principles require that personal financial statements include a provision for estimated income taxes on the differences between the estimated current values of assets and the estimated current amounts of liabilities and their tax bases. The accompanying financial statements do not include such a provision and the effect of this departure from generally accepted accounting principles has not been determined.

[Source: AICPA *Personal Financial Statements Guide*.]

**.17 Review Report—Income Tax Basis**

I (we) have reviewed the accompanying statement of assets and liabilities—historical cost basis of James and Jane Person as of *[date]*, and the related statement of changes in net assets—historical cost basis for the *[period]* then ended, in accordance with standards established by the American Institute of Certified Public Accountants. All information included in these financial statements is the representation of James and Jane Person.

A review of personal financial statements consists principally of inquiries of the individuals whose financial statements are presented and analytical procedures applied to financial data. It is substantially less in scope than an examination in accordance with generally accepted auditing standards, the objective of which is the expression of an opinion regarding the financial statements taken as a whole. Accordingly, I (we) do not express such an opinion.

Based on my (our) review, I am (we are) not aware of any material modifications that should be made to the accompanying financial statements in order for them to be in conformity with the historical cost basis of accounting described in Note X.

[Source: AICPA *Personal Financial Statements Guide*.]

---

[The next page is 10,901.]



## AAM Section 10,700

# ***Accountants' Reports on Basic or General Purpose Financial Statements for State and Local Governmental Units***

### **.01 Unqualified Opinion on General Purpose or Component Unit Financial Statements Only**

#### **Independent Auditor's Report**

We have audited the accompanying general purpose financial statements of City of Example, Any State as of December 31, 19XX, and for the year then ended. These general purpose financial statements are the responsibility of City of Example, Any State management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of City of Example, Any State as of December 31, 19XX, and the results of its operations and changes in financial position of its proprietary fund types for the year then ended in conformity with generally accepted accounting principles.

[Signature]

[Date]

**.02 Unqualified Opinion on General Purpose or Component Unit Financial Statements Submitted Together With Combining, Individual Fund, and Account Group Financial Statements and Supporting Schedules as Supplementary Data**

**Independent Auditor's Report**

We have audited the accompanying general purpose financial statements of City of Example, Any State as of December 31, 19XX, and for the year then ended. These general purpose financial statements are the responsibility of City of Example, Any State management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of City of Example, Any State as of December 31, 19XX, and the results of its operations and changes in financial position of its proprietary fund types for the year then ended in conformity with generally accepted accounting principles.

Our audit was made for the purpose of forming an opinion on the general purpose\* financial statements taken as a whole. The combining, individual fund, and individual account group financial statements and schedules listed in the table of contents are presented for purposes of additional analysis and are not a required part of the general purpose financial statements of the City of Example, Any State. Such information has been subjected to the auditing procedures applied in the audit of the general purpose\* financial statements and, in our opinion, is fairly stated in all material respects in relation to the general purpose\* financial statements taken as a whole.

[Signature]

[Date]

---

\* If the financial statements are for a component unit, the term "general purpose financial statements" should not be used. In the case of a component unit other than the oversight unit, the term "component unit financial statements" or just "financial statements" should be used. For the component unit financial statements of an oversight unit, see AAM section 10,700.04.

**.03 Unqualified Opinion on General Purpose or Component Unit Financial Statements and Combining, Individual Fund, and Account Group Financial Statements Presented Together With Supporting Schedules Reported on as Supplementary Data**

**Independent Auditor's Report**

We have audited the accompanying general purpose financial statements of City of Example, Any State, and the combining, individual fund, and account group financial statements of the City, as of December 31, 19XX, and for the year then ended. These financial statements are the responsibility of City of Example, Any State management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the general purpose\* financial statements referred to above present fairly, in all material respects, the financial position of the City of Example, Any State, at December 31, 19XX, and the results of its operations and the changes in financial position of its proprietary fund types for the year then ended, in conformity with generally accepted accounting principles. Also, in our opinion, the combining, individual fund, and account group financial statements referred to above present fairly, in all material respects, the financial position of each of the individual funds and account groups of the City of Example, Any State, at December 31, 19XX, and the results of operations of such funds and the changes in financial position of individual proprietary funds for the year then ended, in conformity with generally accepted accounting principles.

Our audit was made for the purpose of forming an opinion on the general purpose\* financial statements taken as a whole and on the combining, individual fund, and individual account group financial statements. The accompanying financial information listed as supporting schedules in the table of contents is presented for purposes of additional analysis and is not a required part of the financial statements of the City of Example, Any State. Such information has been subjected to the auditing procedures applied in the examination of the general purpose,\* combining, individual fund, and individual account group financial statements and, in our opinion, is fairly stated in all material respects in relation to the financial statements of each of the respective individual funds and account groups, taken as a whole.

[Signature]

[Date]

---

\* If the financial statements are for a component unit, the term "general purpose financial statements" should not be used. In the case of a component unit other than the oversight unit, the term "component unit financial statements" or just "financial statements" should be used. For the component unit financial statements of an oversight unit, see AAM section 10,700.04.

**.04 Unqualified Opinion on Component Unit Financial Statements of an Oversight Unit That Omit the Financial Statements of All Other Component Units**

**Independent Auditor's Report**

We have audited the accompanying component unit financial statements of City of Example, Any State, oversight unit, as of December 31, 19XX, and for the year then ended. These component unit financial statements of the City of Example, Any State, oversight unit, are the responsibility of City of Example, Any State management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The financial statements referred to above include only the financial activities of the oversight unit. Financial activities of other component units that form the reporting entity are not included.

In our opinion, the component unit financial statements referred to above present fairly, in all material respects, the financial position of City of Example, Any State, oversight unit, as of December 31, 19XX, and the results of its operations and changes in financial position of its proprietary fund types for the year then ended in conformity with generally accepted accounting principles.

[Signature]

[Date]

**.05 Qualified Opinion on General Purpose Financial Statements That Omit One or More, but Not All, Component Units of the Reporting Entity**

**Independent Auditor's Report**

We have audited the accompanying general purpose financial statements of City of Example, Any State as of December 31, 19XX, and for the year then ended. These general purpose\* financial statements are the responsibility of City of Example, Any State management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The general purpose financial statements referred to above do not include financial activities of the [*identify the component unit omitted*], which should be included to conform with generally accepted accounting principles. If the omitted component unit had been included,\* the assets and revenues of the [*identify fund type(s), e.g., special revenue fund type*] would have increased by \$XXX,XXX and \$XXX,XXX, respectively, there would have been an excess of expenditures over revenues in that fund type for the year of \$XXX,XXX, and the [*identify fund type(s)*] fund balance would have been a deficit of \$XXX,XXX.

In our opinion, except for the effects on the financial statements of the omission described in the preceding paragraph, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of City of Example, Any State as of December 31, 19XX, and the results of its operations and changes in financial position of its proprietary fund types for the year then ended in conformity with generally accepted accounting principles.

[Signature]

[Date]

---

**NOTE:**

If the omission was sufficiently material, the auditor should express an adverse opinion on the general purpose financial statements. In such case, the opinion paragraph should state all the substantive reasons for the adverse opinion and the principal effects of those matters.

---

\* If the amounts applicable to the omitted component have not been audited, insert the phrase "based on unaudited information."



**.06 Qualified Opinion on General Purpose or Component Unit Financial Statements That Omit a Fund Type or Account Group****Independent Auditor's Report**

We have audited the accompanying general purpose\* financial statements of City of Example, Any State as of December 31, 19XX, and for the year then ended. These general purpose financial statements are the responsibility of City of Example, Any State management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The general purpose financial statements referred to above do not include the [*identify the fund type (account group) omitted*], which should be included to conform with generally accepted accounting principles. The omitted fund type\*\* has assets, liabilities, revenues, and expenditures of \$XXX,XXX, \$XXX,XXX, \$XXX,XXX, and \$XXX,XXX, respectively. (The amount that should be recorded in the general fixed assets account group is not known.)

In our opinion, except for the effect on the financial statements of the omission described in the preceding paragraph, the general purpose\* financial statements referred to above present fairly, in all material respects, the financial position of City of Example, Any State as of December 31, 19XX, and the results of its operations and the changes in financial position of its proprietary fund types for the year then ended, in conformity with generally accepted accounting principles.

[Signature]

[Date]

---

NOTE:

If the omission was sufficiently material, the auditor should express an adverse opinion on the financial statements. In such case, the opinion paragraph should state all the substantive reasons for the adverse opinion and the principal effects of those matters.

---

\* If the financial statements are for a component unit, the term "general purpose financial statements" should not be used. In the case of a component unit other than the oversight unit, the term "component unit financial statements" or just "financial statements" should be used. For the component unit financial statements of an oversight unit, the principles in AAM section 10,700.04 should be combined with this section.

\*\* If the amounts applicable to the omitted fund type have not been audited, insert the phrase "based on unaudited information."

**.07 Qualified Opinion on General Purpose or Component Unit Financial Statements That Omit a Fund From a Fund Type****Independent Auditor's Report**

We have audited the accompanying general purpose\* financial statements of City of Example, Any State as of December 31, 19XX, and for the year then ended. These general purpose financial statements are the responsibility of City of Example, Any State management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The general purpose financial statements referred to above do not include the [*identify the omitted fund*], which should be included to conform with generally accepted accounting principles. If the omitted fund\*\* had been included, the [*identify fund type*] assets, liabilities, revenues, and expenditures would have increased \$XXX,XXX, \$XXX,XXX, \$XXX,XXX, and \$XXX,XXX, respectively.

In our opinion, except for the effect on the financial statements of the omission described in the preceding paragraph, the general purpose\* financial statements referred to above present fairly, in all material respects, the financial position of City of Example, Any State as of December 31, 19XX, and the results of its operations and the changes in financial position of its proprietary fund types for the year then ended, in conformity with generally accepted accounting principles.

[Signature]

[Date]

---

**NOTE:**

If the omission was sufficiently material, the auditor should express an adverse opinion on the financial statements. In such case, the opinion paragraph should state all the substantive reasons for the adverse opinion and the principal effects of those matters.

---

\* If the financial statements are for a component unit, the term "general purpose financial statements" should not be used. In the case of a component unit other than the oversight unit, the term "component unit financial statements" or just "financial statements" should be used. For the component unit financial statements of an oversight unit, the principles in AAM section 10,700.04 should be combined with this section.

\*\* If the amounts applicable to the omitted fund have not been audited, insert the phrase "based on unaudited information."

**.08 Unqualified Opinion on General Fund Financial Statements With a Middle Paragraph Calling Attention to the Fact That the Financial Statements Do Not Represent the Financial Position and Results of Operations of the Governmental Unit**

**Independent Auditor's Report**

We have audited the accompanying financial statements of the general fund of the City of Example, Any State as of December 31, 19XX, and for the year then ended. These financial statements of the general fund are the responsibility of City of Example, Any State management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described more fully in Note \_\_, the financial statements present only the general fund and are not intended to present fairly the financial position and results of operations of City of Example in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the general fund of the City of Example, Any State as of December 31, 19XX, and the results of its operations for the year then ended in conformity with generally accepted accounting principles.

[Signature]

[Date]

**.09 Unqualified Opinion on an Enterprise Fund's Financial Statements With a Middle Paragraph Calling Attention to the Fact That the Financial Statements Do Not Represent the Financial Position and Results of Operations of the Governmental Unit**

**Independent Auditor's Report**

We have audited the accompanying financial statements of the [*identify enterprise fund*] of the City of Example, Any State as of December 31, 19XX, and for the year then ended. These financial statements of the [*identify enterprise fund*] are the responsibility of City of Example, Any State management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

As described more fully in Note \_\_, the financial statements present only the [*identify enterprise fund*] and are not intended to present fairly the financial position and results of operations of City of Example in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly, in all material respects, the financial position of the [*identify enterprise fund*] of the City of Example, Any State as of December 31, 19XX, and the results of its operations and changes in financial position for the year then ended in conformity with generally accepted accounting principles.

[Signature]

[Date]

**.10 Unqualified Opinion on General Purpose or Component Unit Financial Statements When a Question Arises About the Ability of a Governmental Unit to Meet Its Debts as They Come Due**

**Independent Auditor's Report**

We have audited the accompanying general purpose\* financial statements of City of Example, Any State as of December 31, 19XX, and for the year then ended. These general purpose financial statements are the responsibility of City of Example, Any State management. Our responsibility is to express an opinion on these financial statements based on our audit.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

In our opinion, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of City of Example, Any State as of December 31, 19XX, and the results of its operations and changes in financial position of its proprietary fund types for the year then ended in conformity with generally accepted accounting principles.

As disclosed in the financial statements, *[include description of reason that a question has arisen about the ability of the governmental unit to meet its debts as they come due]*. The financial statements do not include any adjustment relating to the amounts and classification of liabilities\*\* that might be necessary if the City of Example is not able to meet its debts as they come due or if such debts are adjusted under the provisions of Chapter 9 of the Federal Bankruptcy Code.

*[Signature]*

*[Date]*

---

\* If the financial statements are for a component unit, the term "general purpose financial statements" should not be used. In the case of a component unit other than the oversight unit, the term "component unit financial statements" or just "financial statements" should be used. For the component unit financial statements of an oversight unit, the principles in AAM section 10,700.04 should be combined with this section.

\*\* If the uncertainty includes questions about the recoverability and classification of recorded asset amounts, that fact should be stated.

**.11 Qualified Opinion on General Purpose Financial Statements That Include an Unaudited Organization, Function, or Activity****Independent Auditor's Report**

We have audited the accompanying general purpose financial statements of City of Example, Any State as of December 31, 19XX, and for the year then ended. These general purpose financial statements are the responsibility of City of Example, Any State management. Our responsibility is to express an opinion on these financial statements based on our audit.

Except as discussed in the following paragraph, we conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit provides a reasonable basis for our opinion.

The general purpose financial statements referred to above, include the financial activities of the [*identify the organization, function, or activity*] that are unaudited. Those financial activities are included in the [*identify fund type or account group*] and represent 18 percent and 24 percent of the assets and revenues, respectively, of that fund type.

In our opinion, except for the effects on the financial statements of such adjustments, if any, as might have been determined to be necessary had we audited the financial statements of [*identify the organization, function, or activity*] referred to above, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of City of Example, Any State as of December 31, 19XX, and the results of its operations and the changes in financial position of its proprietary fund types for the year then ended, in conformity with generally accepted accounting principles.

[Signature]

[Date]

**.12 Unqualified Opinion on General Purpose Financial Statements With Reference to Audit of Part of a Fund Type by Another Auditor****Independent Auditor's Report**

We have audited the accompanying general purpose financial statements of City of Example, Any State as of December 31, 19XX, and for the year then ended. These general purpose financial statements are the responsibility of City of Example, Any State management. Our responsibility is to express an opinion on these financial statements based on our audit. We did not audit the financial statements of *[identify component unit or fund]*, which represent 20 percent and 22 percent, respectively, of the assets and revenues of the *[identify fund type]*. Those financial statements were audited by other auditors whose report thereon has been furnished to us and our opinion expressed herein, insofar as it relates to the amounts included for *[identify component unit or fund]*, is based solely upon the report of the other auditors.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based upon our audit and the report of other auditors, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of the City of Example, Any State as of December 31, 19XX, and the results of its operations and the changes in financial position of its proprietary fund types for the year then ended, in conformity with generally accepted accounting principles.

*[Signature]*

*[Date]*

**.13 Unqualified Opinion on General Purpose Financial Statements With Reference to Audit of All of a Fund Type by Another Auditor****Independent Auditor's Report**

We have audited the accompanying general purpose financial statements of City of Example, Any State as of December 31, 19XX, and for the year then ended. These general purpose financial statements are the responsibility of City of Example, Any State management. Our responsibility is to express an opinion on these financial statements based on our audit. We did not audit the financial statements of *[identify fund type]*, which represent the amounts shown as the *[identify fund type]*. Those financial statements were audited by other auditors whose report thereon has been furnished to us and our opinion expressed herein, insofar as it relates to the amounts included for *[identify fund type]*, is based solely upon the report of the other auditors.

We conducted our audit in accordance with generally accepted auditing standards. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the financial statements are free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the financial statements. An audit also includes assessing the accounting principles used and significant estimates made by management, as well as evaluating the overall financial statement presentation. We believe that our audit and the report of other auditors provide a reasonable basis for our opinion.

In our opinion, based upon our audit and the report of other auditors, the general purpose financial statements referred to above present fairly, in all material respects, the financial position of the City of Example, Any State as of December 31, 19XX, and the results of its operations and the changes in financial position of its proprietary fund types for the year then ended, in conformity with generally accepted accounting principles.

*[Signature]*

*[Date]*



**.14 Report on Financial Statements Prepared in Accordance With a Comprehensive Basis of Accounting Other Than Generally Accepted Accounting Principles\***

We have examined the financial statements of the individual funds of the City of Example, Any State, as of and for the year ended June 30, 19XX, as listed in the table of contents. Our examination was made in accordance with generally accepted auditing standards and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

As described in Note \_\_\_\_, the City's policy is to prepare its financial statements on a prescribed basis of accounting that demonstrates compliance with the cash basis and budget laws of Any State. This practice differs from generally accepted accounting principles. Accordingly, the accompanying financial statements are not intended to present financial position and results of operations in conformity with generally accepted accounting principles.

In our opinion, the financial statements referred to above present fairly the cash and unencumbered cash balances of each of the various funds of the City of Example, Any State, at June 30, 19XX, and the revenues received and expenditures paid of such funds for the year then ended, on the basis of accounting described in Note \_\_\_\_, which basis has been applied in a manner consistent with that of the preceding year.

[Source: AICPA Audit and Accounting Guide, *Audits of State and Local Governmental Units*, Appendix A, page 208.]

---

\* Editor's Note: This section will be changed, in a future update, to conform to changes made to the Audit and Accounting Guide, *Audits of State and Local Governmental Units*.

**.15 Report on Supplementary Information Schedule of Federal Financial Assistance\***

We have examined the general purpose financial statements of the City of Example, Any State, for the year ended June 30, 19XX, and have issued our report thereon dated September 21, 19XX. Our examination of such general purpose financial statements was made in accordance with generally accepted auditing standards and the standards for financial and compliance audits contained in the *Standards for Audit of Governmental Organizations, Programs, Activities, and Functions*, issued by the U.S. General Accounting Office, and accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

Our examination was made for the purpose of forming an opinion on the general purpose financial statements taken as a whole. The accompanying Schedule of Federal Financial Assistance is presented for purposes of additional analysis and is not a required part of the general purpose financial statements. The information in that schedule has been subjected to the auditing procedures applied in the examination of the general purpose financial statements and, in our opinion, is fairly stated in all material respects in relation to the general purpose financial statements taken as a whole.

[Source: AICPA Audit and Accounting Guide, *Audits of State and Local Governmental Units*, Appendix A, page 209.]

---

\*Editor's Note: This section will be changed, in a future update, to conform to changes made to the Audit and Accounting Guide, *Audits of State and Local Governmental Units*.

## **.16 Compliance Report Based on an Examination of General Purpose or Basic Financial Statements Performed in Accordance With the Standards for Audit Issued by the GAO\***

We have examined the general purpose<sup>1</sup> financial statements of the City of Example, Any State, for the year ended June 30, 19XX, and have issued our report thereon dated September 21, 19XX. Our examination was made in accordance with generally accepted auditing standards and the standards for financial and compliance audits contained in the *Standards for Audit of Governmental Organizations, Programs, Activities, and Functions*, issued by the U.S. General Accounting Office, and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The management of the City of Example is responsible for the City's compliance with laws and regulations. In connection with our examination referred to above, we selected and tested transactions and records to determine the City's compliance with laws and regulations noncompliance with which could have a material effect on the general purpose financial statements of the City.

The results of our tests indicate that for the items tested, the City of Example, Any State, complied with those provisions of laws and regulations noncompliance with which could have a material effect on the general purpose financial statements. Nothing came to our attention that caused us to believe that for the items not tested the City of Example, Any State, was not in compliance with laws or regulations noncompliance with which could have a material effect on the City's general purpose financial statements.<sup>2</sup>

[Source: AICPA Audit and Accounting Guide, *Audits of State and Local Governmental Units*, Appendix A, page 209.]

\* Editor's Note: This section will be changed, in a future update, to conform to changes made to the Audit and Accounting Guide, *Audits of State and Local Governmental Units*.

---

<sup>1</sup> For reports on basic financial statements the word *basic* would be substituted for *general purpose* throughout the report.

<sup>2</sup> If the auditor's testing of compliance with laws and regulations identifies noncompliance with laws and regulations, the last paragraph of the report on compliance should be modified as follows:

The results of our tests indicate that for the transactions tested, the City of Example, Any State, complied with those laws and regulations referred to above, except as described in the attached schedule. Those instances of noncompliance were considered by us in evaluating whether the general purpose financial statements are presented fairly in conformity with generally accepted accounting principles. With respect to the transactions not tested, nothing came to our attention to indicate that the City of Example, Any State, had not complied with laws and regulations other than those laws and regulations for which we noted violations in our testing referred to above.

In the event exceptions are reported as a result of tests performed, the auditor should consider the extent to which the pervasiveness of reported exceptions may affect the auditor's ability to express negative assurance with respect to items not tested.

## **.17 Report on Compliance With Laws and Regulations Related to Major and Nonmajor Federal Financial Assistance Programs\***

We have examined the general purpose financial statements of the City of Example, Any State, for the year ended June 30, 19XX, and have issued our report thereon dated September 21, 19XX. Our examination was made in accordance with generally accepted auditing standards; the standards for financial and compliance audits contained in the *Standards for Audit of Governmental Organizations, Programs, Activities, and Functions*, issued by the U.S. General Accounting Office; the Single Audit Act of 1984; and the provisions of OMB Circular A-128, *Audits of State and Local Governments* and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The management of the City of Example, Any State, is responsible for the City's compliance with laws and regulations. In connection with the examination referred to above, we selected and tested transactions and records from each major federal financial assistance program and certain nonmajor federal financial assistance programs.<sup>1</sup> The purpose of our testing of transactions and records from those federal financial assistance programs was to obtain reasonable assurance that the City of Example, Any State, had, in all material respects, administered major programs, and executed the tested nonmajor program transactions, in compliance with laws and regulations, including those pertaining to financial reports and claims for advances and reimbursements, noncompliance with which we believe could have a material effect on the allowability of program expenditures.

Our testing of transactions and records selected from major federal financial assistance programs disclosed instances of noncompliance with those laws and regulations. All instances of noncompliance that we found and the programs to which they relate are identified in the accompanying schedule of findings and questioned costs.<sup>2, 3</sup>

In our opinion, subject to the effect of the ultimate resolution of those instances of noncompliance referred to in the preceding paragraph,<sup>3</sup> for the year ended June 30, 19XX, the City of Example, Any State, administered each of its major federal financial assistance programs in compliance, in all material respects, with laws and regulations, including those pertaining to financial reports and claims for advances and reimbursements, noncompliance with which we believe could have a material effect on the allowability of program expenditures.

The results of our testing of transactions and records selected from nonmajor federal financial assistance programs indicate that for the transactions and records tested, the City of Example, Any State, complied with the laws and

---

<sup>1</sup> If, in connection with both the examination of the general purpose financial statements and the study and evaluation of internal controls used in administering federal financial assistance programs, the auditor selected for testing compliance no transactions from nonmajor federal assistance programs, the auditor would make no reference to testing of such transactions in the report on compliance with laws and regulations.

The auditor should perform his examination with an awareness of the possibility that illegal acts may have occurred. Such awareness and the consideration of all facts that come to his attention during the examination provide the basis for the auditor's expression of negative assurance concerning compliance with laws and regulations in the execution of transactions that the auditor has not tested. Thus, the auditor may provide this negative assurance in situations in which he has not tested any transactions from nonmajor federal financial assistance programs.

<sup>2</sup> The *Standards for Audit of Governmental Organizations, Programs, Activities, and Functions*, issued by the U.S. General Accounting Office, states that well-developed findings generally consist of the following (see AICPA Audit and Accounting Guide, *Audits of State and Local Governmental Units*, chapter 23, for further explanation):

- A statement of condition
- The criteria
- The effect
- The cause

It is recognized that the auditor may not be able to fully develop all of these points for each instance of noncompliance given the scope and purpose of single audits. The auditor should attempt to identify the condition, criteria, effect, and cause to provide sufficient information to federal, state, and local officials to permit timely and proper corrective action. These findings may also serve as a basis for a federal agency's conducting or contracting for additional audit work.

<sup>3</sup> In the event that the auditor concludes that the ultimate resolution of instances of noncompliance could not have a material effect on the allowability of expenditures of the identified programs, a statement to that effect should be included in the third paragraph and an unqualified opinion issued.

regulations referred to in the second paragraph of our report, except as noted in the accompanying schedule of findings and questioned costs. Our testing was more limited than would be necessary to express an opinion on whether the City of Example, Any State, administered those programs in compliance in all material respects with those laws and regulations noncompliance with which we believe could have a material effect on the allowability of program expenditures; however, with respect to the transactions and records that were not tested by us, nothing came to our attention to indicate that the City of Example, Any State, had not complied with laws and regulations other than those laws and regulations for which we noted violations in our testing referred to above.<sup>4</sup>

[Source: AICPA Audit and Accounting Guide, *Audits of State and Local Governmental Units*, Appendix A, page 210.]

---

\* Editor's Note: This section will be changed, in a future update, to conform to changes made to the Audit and Accounting Guide, *Audits of State and Local Governmental Units*.

---

<sup>4</sup> If the auditor's testing of transactions selected from either major or nonmajor federal financial assistance programs identifies violations of laws and regulations, the auditor should consider whether the extent of those violations is so pervasive that it would preclude the expression of negative assurance on the entity's compliance with laws and regulations as they apply to the items not tested. If the auditor concludes that the extent of such violations precludes the expression of negative assurance, the last paragraph of the report on compliance should be modified as follows:

The results of our testing of transactions and records selected from nonmajor federal financial assistance programs indicate that for the transactions and records tested the City of Example, Any State, complied with those laws and regulations referred to above, except as noted in the accompanying schedule of findings and questioned costs. Our testing was more limited than would be necessary to express an opinion on whether the City of Example, Any State, administered those programs in compliance in all material respects with those laws and regulations noncompliance with which we believe could have a material effect on the allowability of program expenditures; however, the extent of noncompliance noted in our testing indicates that, with respect to the transactions that occurred in the administration of nonmajor federal financial assistance programs and that were not tested by us, there is more than a relatively low risk that the City of Example, Any State, may have violated applicable laws and regulations.

**.18 Report on Compliance With Laws and Regulations Related to Nonmajor Federal Financial Assistance Programs in Circumstances in Which the Recipient Received No Major Program Funding \***

We have examined the general purpose financial statements of the City of Example, Any State, for the year ended June 30, 19XX, and have issued our report thereon dated September 21, 19XX. Our examination was made in accordance with generally accepted auditing standards; the standards for financial and compliance audits contained in the *Standards for Audit of Governmental Organizations, Programs, Activities, and Functions*, issued by the U.S. General Accounting Office; the Single Audit Act of 1984; and the provisions of OMB Circular A-128, *Audits of State and Local Governments*, and, accordingly, included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

The management of the City of Example, Any State, is responsible for the City's compliance with laws and regulations. In connection with the examination referred to above, we selected and tested transactions and records from nonmajor federal financial assistance programs to determine the City's compliance with laws and regulations noncompliance with which we believe could have a material effect on the allowability of program expenditures.

The results of our tests indicate that for the transactions and records tested the City of Example, Any State, complied with the laws and regulations referred to above, except as described in the accompanying schedule of findings and questioned costs. Our testing was more limited than would be necessary to express an opinion on whether the City of Example, Any State, administered those programs in compliance in all material respects with laws and regulations noncompliance with which we believe could have a material effect on the allowability of program expenditures; however, with respect to the transactions that were not tested by us, nothing came to our attention to indicate that the City of Example, Any State, had violated laws and regulations other than those laws and regulations for which we noted violations in our testing referred to above.<sup>1</sup>

[Source: AICPA Audit and Accounting Guide, *Audits of State and Local Governmental Units*, Appendix A, page 213.]

---

\* Editor's Note: This section will be changed, in a future update, to conform to changes made to the Audit and Accounting Guide, *Audits of State and Local Governmental Units*.

---

<sup>1</sup> If the auditor concludes that the extent of such violations precludes the expression of negative assurance, the last paragraph of the report on compliance should be modified as follows:

However, the extent of noncompliance noted in our testing indicates that, with respect to the transactions that occurred in the administration of nonmajor federal financial assistance programs and that were not tested by us, there is more than a relatively low risk that the City of Example, Any State, may have violated applicable laws and regulations.

**.19 Report on Internal Accounting Controls Based Solely on a Study and Evaluation Made as a Part of an Examination of the General Purpose or Basic Financial Statements\***

We have examined the general purpose financial statements of City of Example, Any State, for the year ended June 30, 19XX, and have issued our report thereon dated September 21, 19XX. As part of our examination, we made a study and evaluation of the system of internal accounting control of City of Example, Any State, to the extent we considered necessary to evaluate the system as required by generally accepted auditing standards and the standards for financial compliance audits contained in the U.S. General Accounting Office *Standards for Audit of Governmental Organizations, Programs, Activities, and Functions*. For the purpose of this report, we have classified the significant internal accounting controls in the following categories: [identify control categories].<sup>1</sup> Our study included all of the control categories listed above (except that we did not evaluate the accounting controls over [identify any category not evaluated] because [state reason for excluding any category from the evaluation]). The purpose of our study and evaluation was to determine the nature, timing, and extent of the auditing procedures necessary for expressing an opinion on the entity's financial statements. Our study and evaluation was more limited than would be necessary to express an opinion on the system of internal accounting control taken as a whole or on any of the categories of controls identified above.

The management of City of Example, Any State, is responsible for establishing and maintaining a system of internal accounting control. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of a system are to provide management with reasonable, but not absolute, assurance that assets are safeguarded against loss from unauthorized use or disposition, and that transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of financial statements in accordance with generally accepted accounting principles. Because of inherent limitations in any system of internal accounting control, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the system to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

Our study and evaluation made for the limited purpose described in the first paragraph would not necessarily disclose all material weaknesses in the system. Accordingly, we do not express an opinion on the system of internal accounting control of City of Example, Any State, taken as a whole or on any of the categories of controls

---

<sup>1</sup> The following are examples of different ways in which controls might be classified. The auditor should modify these examples or use other classifications as appropriate for the particular circumstances on which he is reporting.

- A. *Cycles of the Entities' Activity*
  - Treasury or financing
  - Revenue/receipts
  - Purchases/disbursements
  - External financial reporting
- B. *Financial Statement Captions*
  - Cash and cash equivalents
  - Receivables
  - Inventory
  - Property and equipment
  - Payables and accrued liabilities
  - Debt
  - Fund balance
- C. *Accounting Applications*
  - Billings
  - Receivables
  - Cash receipts
  - Purchasing and receiving
  - Accounts payable
  - Cash disbursements
  - Payroll
  - Inventory control
  - Property and equipment
  - General ledger

identified in the first paragraph. However, our study and evaluation disclosed the following conditions that we believe result in more than a relatively low risk that errors or irregularities in amounts that would be material in relation to the financial statements of City of Example, Any State, may occur and not be detected within a timely period.<sup>2</sup> (A description of the material weaknesses that have come to the auditor's attention would follow; if the study and evaluation discloses no material weaknesses, this sentence should state, "However, our study and evaluation disclosed no condition that we believe to be a material weakness," and the following paragraph of this report would be omitted.)

These conditions were considered in determining the nature, timing, and extent of the audit tests to be applied in our examination of the 19XX financial statements, and this report does not affect our report on the financial statements dated September 21, 19XX.

This report is intended solely for the use of management and [*specify legislative or regulatory body*] and should not be used for any other purpose. This restriction is not intended to limit the distribution of this report which, upon acceptance by the [*specify legislative or regulatory body*], is a matter of public record.

[Source: AICPA Audit and Accounting Guide, *Audits of State and Local Governmental Units*, Appendix A, page 214.]

---

\* Editor's Note: This section will be changed, in a future update, to conform to changes made to the Audit and Accounting Guide, *Audits of State and Local Governmental Units*.

---

<sup>2</sup> (a) All material weaknesses that have come to the auditor's attention during the audit would be described, whether or not they relate to a category of controls that was excluded from the study and evaluation. Though only material weaknesses in internal controls need be reported, the auditor may wish to report nonmaterial weaknesses to management. This may be accomplished in the auditor's letter to management or through some similar method of communication. If a letter to management is prepared, the auditor should refer to that communication in this report.

(b) *The Standards for Audit of Governmental Organizations, Programs, Activities, and Functions*, issued by the U.S. General Accounting Office, states that well-developed findings concerning material weaknesses in internal controls generally consist of the following (see AICPA Audit and Accounting Guide, *Audits of State and Local Governmental Units*, chapter 23, for further explanation):

- A statement of condition
- The criteria
- The effect
- The cause

It is recognized that the auditor may not be able to fully develop all of these points for each material weakness found, given the scope and purpose of the control study. The auditor should attempt to identify the condition, criteria, effect, and cause to provide sufficient information to federal, state, and local officials to permit timely and proper corrective action. These findings may also serve as a basis for a federal agency's conducting or contracting for additional audit work.



## **.20 Report on Internal Controls (Accounting and Administrative)—Based on a Study and Evaluation Made as a Part of an Examination of the General Purpose or Basic Financial Statements and the Additional Tests Required by the Single Audit Act\***

We have examined the general purpose financial statements of the City of Example, Any State, for the year ended June 30, 19XX, and have issued our report thereon dated September 21, 19XX. As part of our examination, we made a study and evaluation of the internal control systems, including applicable internal administrative controls, used in administering federal financial assistance programs to the extent we considered necessary to evaluate the systems as required by generally accepted auditing standards, the standards for financial and compliance audits contained in the *Standards for Audit of Governmental Organizations, Programs, Activities, and Functions*, issued by the U.S. General Accounting Office, the Single Audit Act of 1984, and the provisions of OMB Circular A-128, *Audits of State and Local Governments*. For the purpose of this report, we have classified the significant internal accounting and administrative controls used in administering federal financial assistance programs in the following categories: [*identify control categories*].<sup>1</sup>

### <sup>1</sup> *Accounting Controls*

Following are examples of different ways in which accounting controls might be classified. The auditor should modify these examples or use other classifications as appropriate for the particular circumstances on which he is reporting.

#### *Cycles of the Entities' Activity*

- Treasury or financing
- Revenue/receipts
- Purchases/disbursements
- External financial reporting

#### *Financial Statement Captions*

- Cash and cash equivalents
- Receivables
- Inventory
- Property and equipment
- Payables and accrued liabilities
- Debt
- Fund balance

#### *Accounting Applications*

- Billings
- Receivables
- Cash receipts
- Purchasing and receiving
- Accounts payable
- Cash disbursements
- Payroll
- Inventory control
- Property and equipment
- General ledger

#### *Controls Used in Administering Federal Programs*

Following are general and specific administrative control categories identified by representatives of the federal government.

*Controls used in administering individual federal financial assistance programs (refer to the AICPA Audit and Accounting Guide, (Audits of State and Local Governmental Units, chapter 22)*

#### *General Requirements*

- Political activity
- Davis-Bacon Act
- Civil rights
- Cash management
- Relocation assistance and real property acquisition
- Federal financial reports

#### *Specific Requirements*

- Types of services
- Eligibility
- Matching level of effort
- Reporting
- Cost allocation
- Special requirements, if any
- Monitoring subrecipients

The management of the City of Example, Any State, is responsible for establishing and maintaining internal control systems used in administering federal financial assistance programs. In fulfilling that responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of internal control systems used in administering federal financial assistance programs are to provide management with reasonable, but not absolute, assurance that, with respect to federal financial assistance programs, resource use is consistent with laws, regulations, and policies; resources are safeguarded against waste, loss, and misuse; and reliable data are obtained, maintained, and fairly disclosed in reports.

Because of inherent limitations in any system of internal accounting and administrative controls used in administering federal financial assistance programs, errors or irregularities may nevertheless occur and not be detected. Also, projection of any evaluation of the systems to future periods is subject to the risk that procedures may become inadequate because of changes in conditions or that the degree of compliance with the procedures may deteriorate.

Our study included all of the applicable control categories listed above. During the year ended June 30, 19XX, the City of Example, Any State, expended X% of its total federal financial assistance under major federal financial assistance programs. With respect to internal control systems used in administering major federal financial assistance programs, our study and evaluation included considering the types of errors and irregularities that could occur, determining the internal control procedures that should prevent or detect such errors and irregularities, determining whether the necessary procedures are prescribed and are being followed satisfactorily, and evaluating any weaknesses.

With respect to the internal control systems used solely in administering the nonmajor federal financial assistance programs of the City of Example, Any State, our study and evaluation was limited to a preliminary review of the systems to obtain an understanding of the control environment and the flow of transactions through the accounting system. Our study and evaluation of the internal control systems used solely in administering the nonmajor federal financial assistance programs of the City of Example, Any State, did not extend beyond this preliminary review phase.<sup>2</sup>

---

<sup>2</sup> (a) If total assistance expended under major federal financial assistance programs is greater than zero but constitutes less than 50% of total federal assistance expended by the government during the year under examination, the auditor should apply the guidance in the audit and accounting guide, chapter 21 in order to satisfy the objectives of the Single Audit Act. When such guidance is applied, the fourth through seventh paragraphs of the report on internal controls used to administer federal financial assistance programs should be modified as follows:

"Our study included all of the applicable control categories listed above. During the year ended June 30, 19XX, the City of Example, Any State, expended X% of its total federal financial assistance under major federal financial assistance programs and the following nonmajor federal financial assistance programs: *[list appropriate nonmajor federal financial assistance programs]*. With respect to internal control systems used in administering these major and nonmajor federal financial assistance programs, our study and evaluation included considering the types of errors and irregularities that could occur, determining the internal control procedures that should prevent or detect such errors and irregularities, determining whether the necessary procedures are prescribed and are being followed satisfactorily, and evaluating any weaknesses.

"With respect to the internal control systems used solely in administering the other nonmajor federal financial assistance programs of the City of Example, Any State, our study and evaluation was limited to a preliminary review of the systems to obtain an understanding of the control environment and the flow of transactions through the accounting system. Our study and evaluation of the internal control systems used solely in administering these nonmajor federal financial assistance programs of the City of Example, Any State, did not extend beyond this preliminary review phase.

"Our study and evaluation was more limited than would be necessary to express an opinion on the internal control systems used in administering the federal financial assistance programs of the City of Example, Any State. Accordingly, we do not express an opinion on the internal control systems used in administering the federal financial assistance programs of the City of Example, Any State. Further, we do not express an opinion on the internal control systems used in administering the major federal financial assistance programs of the City of Example, Any State.

"Also, our examination, made in accordance with the standards mentioned above, would not necessarily disclose material weaknesses in the internal control systems for which our study and evaluation was limited to a preliminary review of the system as discussed in the fifth paragraph of this report."

(b) If the government had no major federal financial assistance programs during the year under examination, the auditor should apply the guidance in the audit and accounting guide, chapter 21 in order to satisfy the objectives of the Single Audit Act. When such guidance is applied, the fourth through seventh paragraphs of the auditor's report on internal controls used to administer federal financial assistance programs should be modified as follows:

Our study and evaluation was more limited than would be necessary to express an opinion on the internal control systems used in administering the federal financial assistance programs of the City of Example, Any State. Accordingly, we do not express an opinion on the internal control systems used in administering the federal financial assistance programs of the City of Example, Any State. Further, we do not express an opinion on the internal control systems used in administering the major federal financial assistance programs of the City of Example, Any State.

Also, our examination, made in accordance with the standards mentioned above, would not necessarily disclose material weaknesses in the internal control systems used solely in administering nonmajor federal financial assistance programs.

However, our study and evaluation and our examination disclosed the following conditions that we believe result in more than a relatively low risk that errors or irregularities in amounts that would be material to a federal financial assistance program may occur and not be detected within a timely period.<sup>3</sup> (A description of the conditions that have come to the auditor's attention would follow; if the study and evaluation and the examination disclose no material weaknesses in relation to a federal financial assistance program, this sentence should state, "However, our study and evaluation and our examination disclosed no condition that we believe to be a material weakness in relation to a federal financial assistance program of the City of Example, Any State," and the following paragraph should be omitted.)

These conditions were considered in determining the nature, timing, and extent of the audit tests to be applied in (1) our examination of the 19XX general purpose financial statements and (2) our examination and review of the City's compliance with laws and regulations noncompliance with which we believe could have a material effect on the allowability of program expenditures for each major federal financial assistance program and nonmajor federal

---

(Footnote Continued)

"Our study included all of the applicable control categories listed above. During the year ended June 30, 19XX, the City of Example, Any State, had no major federal financial assistance programs and expended X% of its total federal financial assistance under the following nonmajor federal financial assistance programs: [list appropriate nonmajor federal financial assistance programs]. With respect to internal control systems used in administering these nonmajor federal financial assistance programs, our study and evaluation included considering the types of errors and irregularities that could occur, determining the internal control procedures that should prevent or detect such errors and irregularities, determining whether the necessary procedures are prescribed and are being followed satisfactorily, and evaluating any weaknesses.

"With respect to the internal control systems used solely in administering the other nonmajor federal financial assistance programs of the City of Example, Any State, our study and evaluation was limited to a preliminary review of the systems to obtain an understanding of the control environment and the flow of transactions through the accounting system. Our study and evaluation of the internal control systems used solely in administering these nonmajor federal financial assistance programs of the City of Example, Any State, did not extend beyond this preliminary review phase.

"Our study and evaluation was more limited than would be necessary to express an opinion on the internal control systems used in administering the federal financial assistance programs of the City of Example, Any State. Accordingly, we do not express an opinion on the internal control systems used in administering the federal assistance programs of the City of Example, Any State.

"Also, our examination, made in accordance with the standards mentioned above, would not necessarily disclose material weaknesses in the internal control systems, for which our study and evaluation was limited to a preliminary review of the systems, as discussed in the fifth paragraph of this report."

<sup>3</sup> (a) All material weaknesses that have come to the auditor's attention during the audit should be described. Though only material weaknesses in internal controls need be reported, the auditor may wish to report nonmaterial weaknesses to management. This may be accomplished in the auditor's letter to management or through some similar method of communication. If a letter to management is prepared, the auditor should refer to that communication in this report.

(b) *The Standards for Audit of Governmental Organizations, Programs, Activities, and Functions*, issued by the U.S. General Accounting Office, states that well-developed findings concerning material weaknesses in internal controls generally consist of a statement of condition, the criteria, the effect, and the cause (see the audit and accounting guide, chapter 23 for further explanation).

It is recognized that the auditor may not be able to fully develop all of these points for each material weakness found, given the scope and purpose of the control study. The auditor should attempt to identify the condition, criteria, effect, and cause to provide sufficient information to federal, state, and local officials to permit timely and proper corrective action. These findings may also serve as a basis for a federal agency's conducting or contracting for additional audit work.

(c) Weaknesses identified relating to controls over nonmajor programs should be reported here or alternatively in a letter to management based on whether they are considered to be material or nonmaterial.

financial assistance programs. This report does not affect our reports on the general purpose financial statement and on the City's compliance with laws and regulations dated September 21, 19XX.

This report is intended solely for the use of management and [*insert name of regulatory agency of other third party*] and should not be used for any other purpose. This restriction is not intended to limit the distribution of this report, which, upon acceptance by the City of Example, Any State, is a matter or public record.

[Source: AICPA Audit and Accounting Guide, *Audits of State and Local Governmental Units*, Appendix A, page 216.]

---

\* Editor's Note: This section will be changed, in a future update, to conform to changes made to the Audit and Accounting Guide, *Audits of State and Local Governmental Units*.

---



## AAM Section 11,000

# QUALITY CONTROL FORMS AND AIDS

These sample quality control documents are presented for illustrative purposes only. They are intended as an aid for users of this Manual who may want points of departure when establishing their own quality control policies and procedures. These illustrations are neither all inclusive nor are they prescribed minimums. Auditors and accountants should rely on professional standards and their individual professional judgment in determining what may be needed in the circumstances.

## TABLE OF CONTENTS

<i>Section</i>	<i>Paragraph</i>
11,100 Quality Control—General . . . . .	.01-.06
11,200 Sample Quality Control Document for a Two-Partner Local CPA Firm . . . .	.01-.12
Firm Background Information . . . . .	.01
Independence . . . . .	.02
Assigning Personnel to Engagements . . . . .	.03
Consultation . . . . .	.04
Supervision . . . . .	.05
Hiring . . . . .	.06
Professional Development . . . . .	.07
Advancement . . . . .	.08
Acceptance and Continuance of Clients . . . . .	.09
Inspection . . . . .	.10
Description of the Firm's Professional Levels . . . . .	.11
Stated Objectives of Firm (Philosophy) . . . . .	.12
11,300 Sample Quality Control Document for a Four-Partner Local CPA Firm . . . .	.01-.12
Firm Background Information . . . . .	.01
Independence . . . . .	.02
Assigning Personnel to Engagements . . . . .	.03
Consultation . . . . .	.04
Supervision . . . . .	.05
Hiring . . . . .	.06
Professional Development . . . . .	.07
Advancement . . . . .	.08
Acceptance and Continuance of Clients . . . . .	.09
Inspection . . . . .	.10
Description of the Firm's Professional Levels . . . . .	.11
Stated Objectives of Firm (Philosophy) . . . . .	.12
11,400 Sample Quality Control Document for a Sole Practitioner CPA Firm	
Without Full-Time Staff . . . . .	.01-.11
Firm Background Information . . . . .	.01
Independence . . . . .	.02
Assigning Personnel to Engagements . . . . .	.03
Consultation . . . . .	.04

<i>Section</i>	<i>Paragraph</i>
11,400 Sample Quality Control Document for a Sole Practitioner CPA Firm Without Full-Time Staff—continued	
Supervision .....	.05
Hiring .....	.06
Professional Development .....	.07
Advancement .....	.08
Acceptance and Continuance of Clients .....	.09
Inspection .....	.10
Stated Objectives of Firm (Philosophy) .....	.11
11,500 Sample Quality Control Document for a Sole Practitioner CPA Firm With Full-Time Staff .....	.01-.11
Firm Background Information .....	.01
Independence .....	.02
Assigning Personnel to Engagements .....	.03
Consultation .....	.04
Supervision .....	.05
Hiring .....	.06
Professional Development .....	.07
Advancement .....	.08
Acceptance and Continuance of Clients .....	.09
Inspection .....	.10
Stated Objectives of Firm (Philosophy) .....	.11
11,600 Sample Quality Control Forms .....	.01-.17
Independence Checklist for Employees .....	.01
Independence and Representation Checklist for Other Auditors .....	.02
Scheduling Request .....	.03
History of Staff Assignments .....	.04
Client History of Personnel Assigned .....	.05
Scheduling Master Plan .....	.06
Consultation Log .....	.07
Consultation Worksheet .....	.08
Pre-Employment Application .....	.09
Interview Report .....	.10
Record of Professional Development .....	.11
Professional Development Summary	
In Hours .....	.12
In Dollars .....	.13
Performance Evaluation .....	.14
Job Evaluation Report .....	.15
Knowledge and Skill Form .....	.16
Employee Annual Performance Appraisal .....	.17
New Client Acceptance Checklist .....	.18
Client Evaluation Questionnaire .....	.19
Summary Inspection Report .....	.20
Inspection of Compliance With Policies and Procedures Relating to Elements of Quality Control .....	.21

---

[The next page is 11,101.]

# AAM Section 11,100

## *Quality Control—General*

.01 Quality control for a CPA firm applies to all auditing, accounting and review services. In providing professional services, a firm has a responsibility to conform with professional standards.

.02 Therefore, a firm shall have a system of quality control, as is required by Statement on Quality Control Standards, *System of Quality Control for a CPA Firm*, which can be found in QC section 10. AICPA members are required to engage in the practice of public accounting only with a firm that is enrolled in an Institute approved practice monitoring program (BL section 220.01, section 2.2.3).

.03 The AICPA Quality Review Executive Committee issued an Exposure Draft entitled *Proposed Standards for Performing and Reporting on Quality Reviews*, on October 10, 1988. The comment deadline for this exposure draft is December 30, 1988. Final issuance of this statement is expected in 1989.

.04 The nature and extent of a firm's quality control policies and procedures depend on a number of factors, such as its size, the nature of its practice, its organization and appropriate cost-benefit considerations.

.05 In establishing quality control policies and procedures, firms consider each of the elements discussed below.

- a. **Independence.** The firm should be assured that persons at all levels maintain independence to the extent required by the rules of conduct of the AICPA.

Forms which may assist you are:

<u>Section</u>	<u>Form Name</u>
11,600.01	Independence Checklist for Employees
11,600.02	Independence Checklist for Other Auditors

- b. **Assigning Personnel to Engagements.** The firm should be assured that work will be performed by persons having the degree of technical training and proficiency required in the circumstances.

Forms which may assist you are:

<u>Section</u>	<u>Form Name</u>
11,600.03	Scheduling Request
11,600.04	History of Staff Assignments
11,600.05	Client History of Personnel Assigned
11,600.06	Scheduling Master Plan

- c. **Consultation.** The firm should be assured personnel will seek assistance, to the extent required, from persons having appropriate levels of knowledge, competence, judgment, and authority.

Forms which may assist you are:

<u>Section</u>	<u>Form Name</u>
11,600.07	Consultation Log
11,600.08	Consultation Worksheet

- d. **Supervision.** The firm should be assured that work at all organizational levels is supervised to ascertain that the work performed meets the firm's standards of quality.

Forms which may assist you are:



<u>Section</u>	<u>Form Name</u>
3155.01-.02	Audit Time Budget
3155.03-.04	Audit Time Analysis
3155.05	Weekly Progress Report
3165.01-.12	Illustrative Planning Checklist
3175.01-.12	Sample Engagement Letters
2200.24	Illustrative Engagement Letter for a Compilation
2200.25	Illustrative Engagement Letter for a Review
5400.010-.460	Illustrative Audit Programs
9100.01-.24	Supervision and Review Procedures
11,600.04	History of Staff Assignments

- e. **Hiring.** The firm should be assured that those employed possess the appropriate characteristics to enable them to perform competently.

Forms which may assist you are:

<u>Section</u>	<u>Form Name</u>
11,600.09	Pre-Employment Application
11,600.10	Interview Report

- f. **Professional Development.** The firm should be assured that personnel will have the knowledge required to enable them to fulfill responsibilities assigned and to comply with applicable (state) Board of Accountancy requirements.

Forms which may assist you are:

<u>Section</u>	<u>Form Name</u>
11,600.11	Record of Professional Development
11,600.12	Professional Development Summary (in hours)
11,600.13	Professional Development Summary (in dollars)

- g. **Advancement.** The firm should be assured that those selected for advancement will have the qualifications necessary for fulfillment of the responsibilities they will be called on to assume.

Forms which may assist you are:

<u>Section</u>	<u>Form Name</u>
11,600.14	Performance Evaluation
11,600.15	Job Evaluation Report
11,600.16	Knowledge and Skill Form
11,600.17	Employee Annual Performance Appraisal

- h. **Acceptance and Continuation of Clients.** The firm should be assured that the decision to accept or continue a client is in the best interest of the firm as well as the client.

Forms which may assist you are:

<u>Section</u>	<u>Form Name</u>
11,600.18	New Client Acceptance Checklist
11,600.19	Client Evaluation Questionnaire
2200.22	Client Acceptance Form
2200.23	Client Information Form

- i. **Inspection.** The firm should be assured that the procedures relating to other elements of quality control are being effectively performed.

Forms which may assist you are:

<u>Section</u>	<u>Form Name</u>
11,600.20	Summary Inspection Report
11,600.21	Inspection of Compliance With Policies and Procedures Relating to Elements of Quality Control

The elements are interrelated. For example, a firm's hiring practices affect its policies as to training, training affects policies as to promotion, etc. The system should be designed to function together to maintain a firm's quality. (This section does not specifically cover services for OCBOA, Agreed-Upon Procedures, Prospective Financial Statements, Internal Control Reports or Attest Engagements. A firm may want to develop alternative Quality Control checklists for these engagements.)

.06 Although firms that have a review of their quality control system are not required to have a formal quality control document, many firms find preparation and dissemination to their staff of such a document useful. The sample quality control documents for local CPA firms and sole practitioners presented in the following sections have been prepared using the information contained in Statement on Quality Control Standards, *System of Quality Control for a CPA Firm*, the interpretations of this statement, and the guide entitled, "Quality Control Policies and Procedures for CPA Firms," which was prepared by the Quality Control Review Committee for use in establishing guidance for the implementation of this statement.

---

[The next page is 11,201.]



# AAM Section 11,200

## *Sample Quality Control Document for a Two-Partner Local CPA Firm*

### .01 Firm Background Information

Our firm was founded in 1962 by our executive partner after he had gained several years experience with a large regional CPA firm. The administrative partner joined the firm as a staff assistant upon his college graduation. Presently we employ three professional staff members and two clerical staff personnel giving our firm a total of seven people. (Our organization chart is on the next page.)

Our objective of providing quality service to clients and our concern for the general public interest has established our reputation in our community and has enabled us to grow through internal expansion.<sup>1</sup> We do not have, nor do we anticipate accepting, publicly held corporations as clients. It is anticipated that much of our future growth will be through expanded service to present clients and the addition of new clients on a regular basis. We intend to hire and train personnel who will be able to grow professionally with us, as needed.

There were approximately 9,250 hours billed during the year ended December 31, 1977, as follows:

Auditing	20%
Unaudited financial statements	32
Taxes	33
Management advisory service	3
Other accounting services	12
	<u>100%</u>

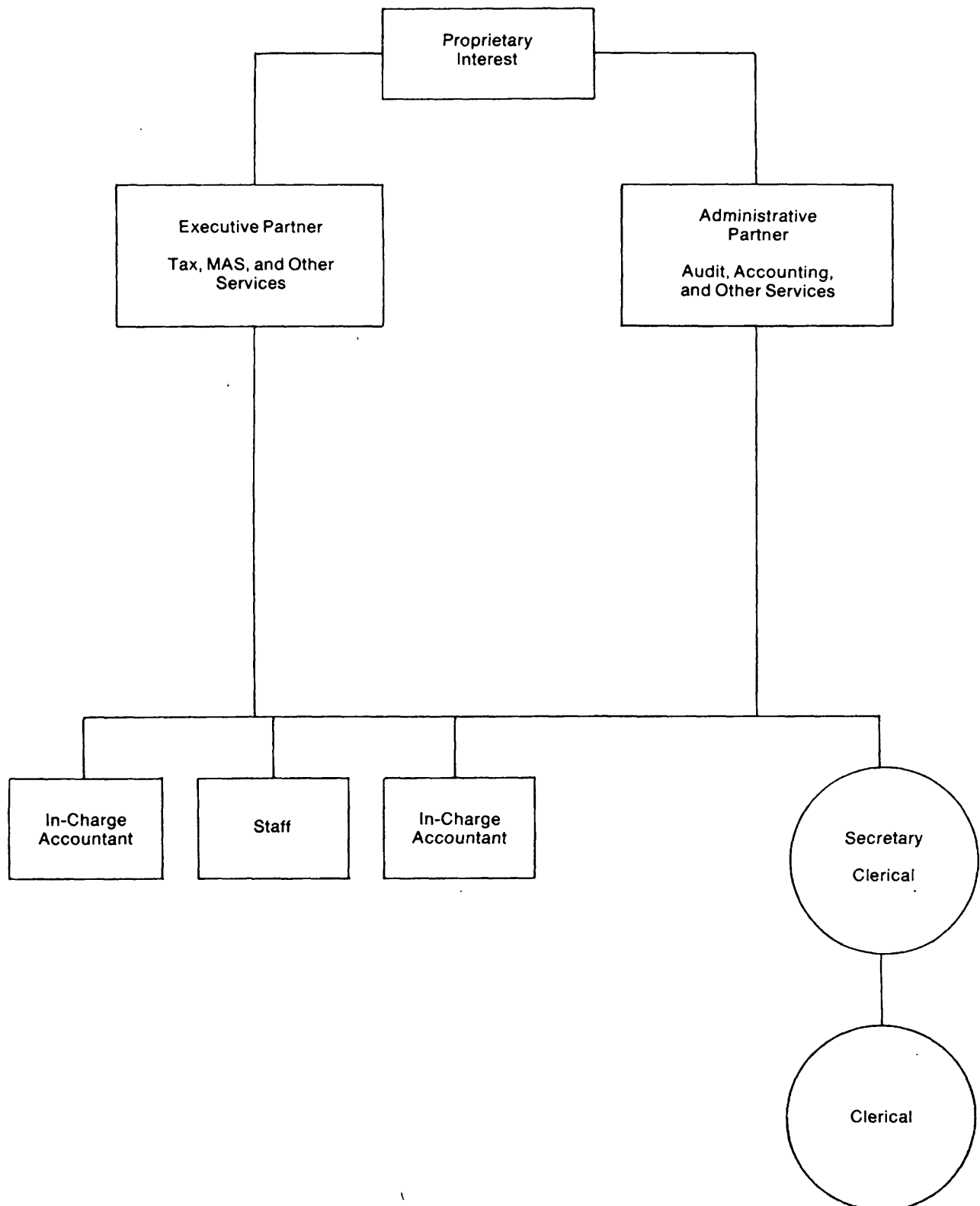
Our practice is conducted from one office, and our audit clientele consists of 14 manufacturing companies, 5 retail establishments, and 2 wholesale distributors. In addition, we have 26 unaudited statements clients and 13 clients for whom we provide other accounting services.

One of our in-charge accountants has 5 years experience and is a CPA, the other has 3 years experience and has passed three parts of the CPA examination. The staff assistant has 1 year experience and has passed two parts of the CPA examination.

February 10, 1978

---

<sup>1</sup> Additional considerations for establishing the firm's stated objectives are discussed in AAM section 11,200.12.

**Organization Chart**

**.02 Independence**

- 1. All personnel are required to adhere to the independence rules, regulations, interpretations, and rulings of the AICPA, (state) CPA Society, (state) Board of Accountancy, and state statute.**
  - a. The executive partner is responsible for resolving questions relating to independence matters and is available to provide guidance when required.
  - b. The executive partner communicates with the AICPA and/or the (state) CPA Society for assistance in resolving independence questions that are not satisfactorily resolved within the firm. (See AAM section 11,600.07 for an example of a log which can be utilized to document all communication with parties outside the firm; see also AAM section 11,600.08 for a Consultation Worksheet which can be used to document the subject matter as well as the response from the consultant.)
  - c. A memorandum documenting the resolution of independence questions is prepared and retained by the executive partner; the other firm personnel involved in the matter review and initial the memorandum.
- 2. Policies and procedures relating to independence are communicated to all personnel.**
  - a. Memorandums are used to inform personnel of the firm's independence policies and procedures and advise them that they are expected to be familiar with those policies and procedures. Rulings and interpretations of the AICPA, (state) CPA Society, (state) Board of Accountancy, and state statute are also made available to personnel.
  - b. Independence of mental attitude is emphasized during the conduct of engagements.
  - c. A current client listing is reviewed with each new employee to ensure that the employee is aware of those entities to which independence policies apply. During the monthly staff meeting, the staff is informed of any changes in the listing.
  - d. Our library contains professional, regulatory, and firm literature relating to independence matters.<sup>2</sup>
- 3. Compliance with policies and procedures relating to independence is monitored.**
  - a. Semiannually, at the June and December monthly staff meetings, provision is made on the agenda for all personnel to review and complete the Independence Checklist for Employees (AAM section 11,600.01). The purpose of the checklist is to indicate that—
    - (i) They are familiar with the firm's independence policies and procedures.
    - (ii) They are not now nor have been holding prohibited investments.
    - (iii) They are not now nor have been involved in relationships or transactions that are prohibited.
  - b. The executive partner is responsible for the resolution of exceptions to the firm's policies and procedures relating to independence.
  - c. Accounts receivable that are past due are reviewed monthly by the executive partner to ascertain whether any outstanding amounts take on some of the characteristics of loans and may, therefore, impair the firm's independence.

**.03 Assigning Personnel to Engagements**

---

<sup>2</sup> The appropriate information may be found in *AICPA Professional Standards*, Volume 2, and in rulings and interpretations of the state CPA societies, the state boards of accountancy, and state statutes.

**1. Our firm's approach to assigning personnel includes the planning of overall firm needs and the measures employed to achieve a balance of engagement manpower requirements, personnel skills, individual development, and utilization.**

- a. On an annual basis, normally in May of each year, the partners jointly develop a projection containing anticipated manpower requirements for the coming year. This can be achieved by obtaining from each partner a scheduling request (AAM section 11,600.03) which enumerates the staff requirements by client.
- b. In scheduling assignments the engagement partner strives to achieve a balance of engagement manpower requirements, personnel skills, individual development, and utilization.

**2. The administrative partner is responsible for assigning personnel to engagements.**

- a. Before making assignments to engagements, the engagement partner considers the nature of the engagement and personnel availability.
- b. The partners attempt to achieve a balance between the need for continuity and for periodic rotation of personnel to the extent practicable.
- c. In order to assist in assigning personnel to engagements as well as obtaining an adequate balance of personnel for each engagement, it is useful to maintain a "History of Staff Assignments" as well as a "Client History of Personnel Assigned"

The "History of Staff Assignments" (AAM section 11,600.04) enumerates, by personnel, the clients a staff member has worked on as well as the type of work performed.

The "Client History of Personnel Assigned" (AAM section 11,600.05) enumerates, by client, the personnel assigned and chargeable hours for the staff member.

Another scheduling tool which may be useful is the "Scheduling Master Plan" (AAM section 11,600.06). This is usually prepared monthly, but depending upon the circumstances, may be prepared quarterly or yearly. The "Scheduling Master Plan" assists the individual responsible for scheduling to maintain a listing by staff of hours (nonworking, working). It further lists the type of working or nonworking hours (i.e., vacation, CPA exam, tax department, etc.). This tool maintains a record of the total hours assigned and available for each individual, including hours over/under assigned.

**.04 Consultation**

**1. Areas and specialized situations where consultation is required are identified, and personnel are encouraged to consult with or use authoritative sources on complex or unusual matters.**

- a. All personnel are advised of our firm's consultation policies and procedures. These policies and procedures are set forth in a memorandum.
- b. A listing of certain areas or specialized situations, which because of the nature or complexity of the subject have been identified as requiring consultation, is updated semiannually by the administrative partner and distributed to all personnel.
- c. A technical reference library is maintained to assist personnel in resolving practice problems. The administrative partner is charged with the responsibility of periodically reviewing the library contents and making necessary additions.
- d. Personnel are encouraged to seek advice from a partner or other staff member when confronted with an unusual or complex situation related to that person's particular expertise.
- e. When expertise is not available within the firm, practice questions and problems are referred by the engagement partner to the Technical Information Division of the AICPA or the (state) CPA Society

established to handle technical inquiries. (See AAM section 11,600.07—.08 to document use of consultants.)

- f. We maintain a consultation agreement with the local office of (firm name) CPAs to provide us with additional expertise. Inquiries to that firm are channeled through the administrative partner.
  - g. The results of outside consultation are reviewed by the partners before a decision is reached.
- 2. Specific individuals have been designated as having specialized experience and expertise in certain technical areas. These individuals are available for consultation to all personnel.**
- a. A listing of our designated technical specialists has been prepared and circulated. The list is updated and recirculated as necessary.
  - b. The executive partner resolves differences of opinion on practice problems. Any party to the discussion who disagrees with the conclusion has the option of preparing a memorandum and filing it with the working papers.
- 3. In those areas and specialized situations where firm policy requires consultation with specialists, a summary of the consultation conclusions and the reasons for the conclusions is required.**
- a. The memorandum (see item 1(a) above) is used to inform personnel of the consultation procedures, the extent of documentation required, and the responsibility for its preparation.
  - b. Consultation summaries are filed with the engagement working papers.
  - c. An example of a log which can be utilized to maintain a listing of consultation is shown in AAM section 11,600.07. This log can be put in the workpapers to document consultants utilized on the engagement as well as to maintain control for follow-up documentation from the specific consultant used.
  - d. An example of a worksheet which can be used to document the consultation with specialists is shown in AAM section 11,600.08.

## **.05 Supervision**

- 1. All engagements are adequately planned by persons knowledgeable about the client and/or the type of engagement.** (For additional information on Planning, review AAM section 3000.)
- a. On all annual recurring engagements where the anticipated manpower requirement is in excess of ten man-days, the in-charge accountant reviews with the engagement partner the following documents from the prior year's files, as applicable, to determine if modifications are appropriate:
    - (i) Engagement letter
    - (ii) Time budget compared with actual time expended
    - (iii) Evaluation of the internal control structure
    - (iv) Audit or work program
    - (v) Engagement notes and memorandums
    - (vi) Financial statements and accountant's report
    - (vii) Management letters
  - b. On all engagements in excess of ten man-days, including annual recurring engagements, new engagements, and special engagements, the in-charge accountant submits to the engagement partner the following, where applicable, for his written approval:



- (i) Engagement letter
- (ii) Time budget
- (iii) Preliminary evaluation of the internal control structure
- (iv) Audit or work program
- (v) A memorandum stating any special problems that may have an impact on the conduct of the engagement

**2. Procedures are provided for maintaining the firm's standards of quality for the work performed.**

- a. Depending upon each individual's background in relation to his assignment, varying degrees of supervision are provided. (See AAM section 11,600.04.)
- b. Copies of forms, checklists, and questionnaires are available for use on engagements.
- c. Differences of opinion among staff members working on an engagement are brought to the attention of the engagement partner. If the partner agrees with the senior party to the dispute, the matter is considered resolved. If no resolution is made at this time, the partners jointly discuss the matter. Any party to the discussion who disagrees with the conclusion has the option of preparing a memorandum and filing it with the working papers.

**3. All engagement working papers and reports are reviewed by appropriate supervisory personnel prior to issuance of the report.** (For additional information on supervision, review AAM section 9000.)

- a. The in-charge accountant reviews and initials all working papers he did not prepare (including those prepared by a partner). The engagement partner reviews the overall engagement (initialing all working papers not reviewed by an in-charge accountant), including financial statements and accountant's report, and discusses with the in-charge accountant any critical audit areas and unusual accounting matters encountered during the course of the engagement. This discussion is documented by a memorandum where appropriate.
- b. In certain circumstances (as outlined in item 1(d) at paragraph .09) prior to the issuance of the financial statements and the auditor's report on them, another partner or an experienced staff member not otherwise associated with the engagement evaluates the appropriateness of financial statement disclosures and the auditor's report in relation to the material discussed in the engagement partner's memorandum.

**.06 Hiring**

**1. The firm endeavors to obtain qualified personnel by planning for personnel needs and establishing hiring objectives.**

- a. The partners annually plan the firm's long-range personnel objectives. Current clientele, anticipated growth, personnel turnover, individual advancement, and retirement are among the criteria considered.
- b. The partners make the employment decisions.

**2. Our firm has established qualifications and guidelines for evaluating potential hirees.** (See AAM section 11,600.09 for an example of a Pre-Employment Application which can be used to determine the individual's qualifications and AAM section 11,600.10 for an example of an Interview Report which can be used to document the interviewer's comments about individuals interviewed for positions within the firm.)

- a. Our firm seeks to employ individuals with high levels of intelligence, integrity, honesty, motivation, and aptitude for the profession.

- b. Our firm normally employs college graduates with a concentration in accounting as full-time permanent members of our professional staff.
  - c. Newly employed staff members are from the top half of their college class, unless other factors such as personal achievements, work experience, and personal interests indicate the likelihood of adequate professional development.
  - d. Our firm normally expects that an applicant's academic preparation will enable him to take the CPA examination as administered by the (state) Board of Accountancy.
  - e. The backgrounds of new employees are appropriately investigated to reasonably assure hiring of persons with acceptable qualifications by obtaining completed application forms, college transcripts, and personal references.
3. **Applicants and new personnel are informed of the firm's policies and procedures relevant to them.**
- a. The firm's personnel policies and procedures relevant to applicants are communicated to them before offers of employment are extended.
  - b. The administrative partner maintains and distributes to all personnel memorandums describing the firm's personnel policies and procedures.
  - c. The administrative partner discusses the firm's personnel policies and procedures with any new employee.

#### **.07 Professional Development**

1. **Guidelines and requirements have been established for the firm's professional development program and are communicated to all personnel.**
- a. The administrative partner is responsible for the formulation and implementation of guidelines and requirements for professional development.
  - b. As part of their orientation, new employees are informed of professional responsibilities and opportunities by the administrative partner.
  - c. Normally, a newly employed person with limited experience is sent to introductory-level training sessions of the AICPA or the (state) CPA Society during the first year of employment with our firm.
  - d. Each partner and professional employee is required to complete a minimum of 40 hours of formal continuing professional education each year. (Firms should determine the specific requirements of their State Board of Accountancy.) Personnel complete the record of professional development form and forward it to the administrative partner. (See section AAM 11,600.11.) The administrative partner is responsible for having the personnel files of each partner and professional employee updated to include a current record of hours of professional development completed. The types of programs qualifying for the fulfillment of the 40-hour requirement include—
    - (i) Continuing professional education programs of the AICPA and the (state) CPA Society. This includes sessions attended and, with written evidence of completion, cassette/workbook or workbook programs.
    - (ii) College courses related to the profession.
  - e. The executive partner annually reviews the firm's professional development program (including personnel participation records) to determine whether it is adequately meeting the firm's needs, providing for the professional growth of individuals, and meeting mandatory continuing education requirements.

- f. In order for the firm to maintain a summary of hours and dollars utilized, as well as to determine that personnel are obtaining a sufficient amount of continuing professional education hours, there are two tools which are helpful.

The first is a "Professional Development Summary (in hours)" (AAM section 11,600.12) chart. This lists by position, each professional and the courses attended. This chart can be used to review each individual's progress toward obtaining the educational requirements.

The second is a "Professional Development Summary (in dollars)" (AAM section 11,600.13) chart. This lists by position, each professional and the cost of each course attended. This chart can be used to review the cost of each individual's educational requirements. This tool is also useful for determining if the present manner utilized by the firm is the most cost effective.

**2. Information about current developments in professional technical standards and materials containing the firm's technical policies and procedures are made available to personnel. Personnel are encouraged to engage in self-development activities.**

- a. It is the responsibility of the administrative partner to distribute statements relating to current developments in accounting and auditing to all personnel not receiving them directly. This includes statements and interpretations issued by the Financial Accounting Standards Board and by the AICPA Auditing Standards Board, and so forth.
- b. Pronouncements relating to areas of specific interest are distributed by the appropriate specialist to persons who have need for such information.
- c. The firm does not, at present, conduct formal in-house training programs. However, from time to time personnel participate in the training programs of (firm name) CPAs.
- d. A library of staff training cassette/workbook programs published by the AICPA and the (state) Society of CPAs is maintained by the administrative partner for self-study and reference purposes.

**3. The firm recognizes that on-the-job training accounts for a significant part of professional development.**

- a. Personnel with in-charge responsibility on engagements—
  - (i) Discuss with assistants the relationship of the work they are performing to the engagement as a whole.
  - (ii) Permit assistants, when practicable, to become involved in areas of the engagement other than those previously assigned.
  - (iii) Explain to assistants the reasons for any additional work requirements discovered through the review process.
- b. Personnel are evaluated in part on their effectiveness in properly training and developing subordinates.

**.08 Advancement**

1. **Our firm has established qualifications deemed necessary for the various levels of responsibility within the firm.**
  - a. Our firm has designated the staff classifications of in-charge accountant and staff assistant. Levels of responsibility inherent in the staff classifications are clearly defined.<sup>3</sup>
  - b. The criteria that are considered in evaluating individual performance and expected proficiency are enumerated in our staff classification guidelines.
2. **The performance of our personnel is continuously evaluated, and personnel are periodically advised of their progress. Personnel files are maintained containing documentation of the evaluation process.** (See AAM section 11,600.14—.15 for examples of Evaluation Forms which may be used for periodic evaluation of staff members. The differences in the forms relate to the amount of time spent on a particular engagement. For example, if a staff member spends 40 or more hours on an engagement, a more thorough evaluation can usually be performed (AAM section 11,600.14). AAM section 11,600.16 would be utilized to evaluate the management skills of the individual being evaluated and therefore does not include specific duties relating to the assignment of work performed.)
  - a. All professional employees receive an evaluation of their performance at least semiannually. Such counseling interviews are conducted by the partners. These evaluations summarize performance on engagements during the year. The individual's progress, strengths, weaknesses, future objectives, and the firm's future objectives are among the items discussed. (See AAM section 11,600.17.)
  - b. Results of evaluations are documented in the individual's personnel file.
3. **The partners make advancement and termination decisions and document the results.**

**.09 Acceptance and Continuance of Clients**

1. **Our firm has established procedures for evaluation of prospective clients and for their acceptance as clients.** (See AAM section 11,600.18 for a New Client Acceptance Checklist which can be used for prospective clients.)
  - a. Available financial information regarding the prospective client (such as annual reports, interim financial statements, and income tax returns) is obtained and reviewed.
  - b. Inquiries about potential clients are made to bankers, attorneys, credit services, and others having business relationships with the company.
  - c. Predecessor auditors, where applicable, are contacted and inquiries are made in accordance with generally accepted auditing standards.
  - d. Consideration is given to circumstances that would cause the firm to regard the engagement as one requiring special attention or presenting unusual risks. These circumstances include the following:
    - (i) Audits where the annual fee is expected to exceed \$5,000 or where the expected man-hour requirement exceeds 150 hours
    - (ii) Audits of firms operating in high risk industries such as those industries where it is difficult to establish adequate systems of internal control or those industries whose operations are especially sensitive to general economic conditions

---

<sup>3</sup> The description of the firm's professional levels, with the responsibilities for each level and the general length of time required for advancement to the next position, can be found in AAM section 11,200.11.

- (iii) Audits of firms in the development stage
- (iv) Audits of firms in serious financial difficulty
- (v) Any of the conditions enumerated in 2(a)(iii)
- e. The firm's independence and ability to adequately serve a potential client are evaluated prior to acceptance. In evaluating the firm's ability, consideration is given to the requirements for technical skills, knowledge of the industry, and personnel.
- f. A review is made to ensure that acceptance of the client would not violate applicable regulatory agency requirements and the code of professional conduct of the AICPA and/or the (state) CPA Society.
- g. Procedures for acceptance of a new engagement are as follows:
  - (i) The engagement partner assembles the information and evaluates all matters in the previous paragraphs.
  - (ii) All engagements are approved in writing by the partners.
- 2. **Clients are evaluated at the end of specific periods or upon the occurrence of certain events to determine whether the relationship should be continued.** (See AAM section 11,600.19 for a Client Evaluation Questionnaire which can be used for evaluating existing clients.)
  - a. Reevaluations of existing clients are made—
    - (i) Annually, if any of the conditions mentioned in 1(d) exist.
    - (ii) Every three years if none of the conditions mentioned in 1(d) exist.
    - (iii) If there is a significant change in one or more of the following:
      - Management or ownership
      - Legal counsel
      - Financial condition
      - Litigation status
      - Nature of client's business
      - Scope of work
    - (iv) Upon the emergence of conditions that would have caused the firm to reject a client had such conditions existed at the time of the initial acceptance.
  - b. Based on the information obtained, both partners make the continuance decision.

## **.10 Inspection**

- 1. **The firm conducts an inspection program regarding its quality control policies and procedures.** (See AAM section 11,600.20 for a Summary Inspection Report which can be used to document the results of a firm's yearly quality review inspection and AAM section 11,600.21 for an Inspection of Compliance with Policies and Procedures Relating to Elements of Quality Control.)
  - a. Each year the partners evaluate the firm's quality control policies and procedures for compliance with professional standards. This procedure includes a review of administrative and personnel files sufficient to obtain reasonable assurance that quality control policies and procedures are being complied with.

- b. A sample of engagements is selected annually from each partner's client listing and is given an in-depth review by the other partner or by a staff member not otherwise associated with the engagement. The working papers and reports are reviewed for compliance with professional standards, including generally accepted auditing standards, generally accepted accounting principles, and with the firm's quality control policies and procedures.
  - c. Annually, the executive partner selects a representative report to be submitted for review to the practice review committee of the (state) Society or the AICPA.
  - d. Every third year the firm undergoes an AICPA quality control compliance review in accordance with AICPA Quality Control Standards.
- 2. Provision is made for reporting inspection findings and for monitoring actions taken or planned.**
- a. The results of engagement reviews are discussed with the personnel responsible for the engagement.
  - b. Inspection findings and recommendations together with corrective actions taken or planned are discussed by the partners. A memorandum outlining the findings and recommendations is prepared and retained by the executive partner.
  - c. The partners determine that planned corrective actions were taken.

## .11 Description of the Firm's Professional Levels

<u>Level</u>	<u>Approximate Time Frame</u>
Staff Assistant	
Level 1	First year (0 to 1)
Level 2	Second and third year (2 to 3)
In-Charge Accountant	Fourth through eighth year (4 to 8)
Partner	After the eighth year

*Staff Assistant (Level 1).* A Level 1 staff assistant is expected to—

- Work on portions of audit and accounting engagements.
- Become familiar with the firm's policies and procedures.
- Know the rules, regulations, and code of conduct of the AICPA and the (state) Society of CPAs.
- Be familiar with pronouncements of the Financial Accounting Standards Board (FASB) and the AICPA, such as the Statements on Auditing Standards (SASs) and Accounting Principles Board Opinions (APBs).
- Progress professionally by working toward passing the CPA examination as soon as possible.

*Staff Assistant (Level 2).* A Level 2 staff assistant should be able to—

- Assume full responsibility under supervision for small accounting engagements involving unaudited financial statements.
- Work on more involved portions of large audit and accounting engagements.
- Prepare financial statements.

*In-Charge Accountant.* An in-charge accountant is expected to—

- Assume full responsibility for small and medium-size audit engagements requiring the services of one or two people and large accounting engagements involving unaudited financial statements.

- Work on (and research) assignments involving “theory” and such “conceptual” areas as materiality and interrelationships of accounts.
- Review and analyze the internal control structure.
- Prepare audit programs and time budgets.
- Be responsible for compliance with due dates and adherence to time budgets.
- Prepare management letters.
- Train and supervise the staff members assigned to the engagement.
- Recognize, in advance, the possible problem areas of an engagement.
- Pass the CPA examination, if not already certified.

#### **.12 Stated Objectives of Firm (Philosophy)**

A particular firm’s stated objectives may include items such as the following:

1. Concern for the general public interest.
  2. Concern for the financial well-being of clients.
  3. Reinvestment of the firm’s profits in the training and advancement of the firm’s partners and staff.
  4. Growth plans for the firm, including opening of branch offices, annual billings, and staff size.
  5. Development of specialties such as auditing governmental units or concentration in particular fields—banks, agriculture, retail, and so forth.
  6. Development of other services, such as a computer data processing center.
  7. Centralization (or decentralization) of authority for issuance of reports.
  8. Degree of operating autonomy for individual practice offices.
  9. Extent of autonomy for partners.
  10. Pattern for firm growth—internal growth through acquisitions of clients and growing apace with them or growth through mergers with other accounting firms.
- 

[The next page is 11,301.]

# AAM Section 11,300

## *Sample Quality Control Document for a Four-Partner Local CPA Firm*

### .01 Firm Background Information

Our firm has four partners, nine professional staff, and four clerical staff—a total of seventeen people. One partner has been designated as the executive partner and another as administrative partner. (A copy of our organization chart follows on the next page.)

Our executive partner founded the firm in 1953, and our growth has been derived entirely from internal expansion. All of the other partners joined the firm as staff assistants and were promoted to partner level.

Our objective is to provide quality accounting, auditing, tax, and management advisory services to our clients.<sup>1</sup> To this end we expect to limit our practice to those clients we can properly serve. We intend to further develop expertise that will enable us to increase the number of clients that are municipalities and savings and loan associations. Therefore, we plan to hire and train professional personnel who will be able to function to meet these goals.

We expect our growth to continue to be internal and to be limited to our present geographic practice area; a community we have served for nearly 25 years. We hope to retain our local identity and personal relationship with clients that are the foundations of our practice.

We hope to be a firm that is enjoyable and rewarding to work for. We intend to continue our involvement in and contribution to community and professional activities and organizations.

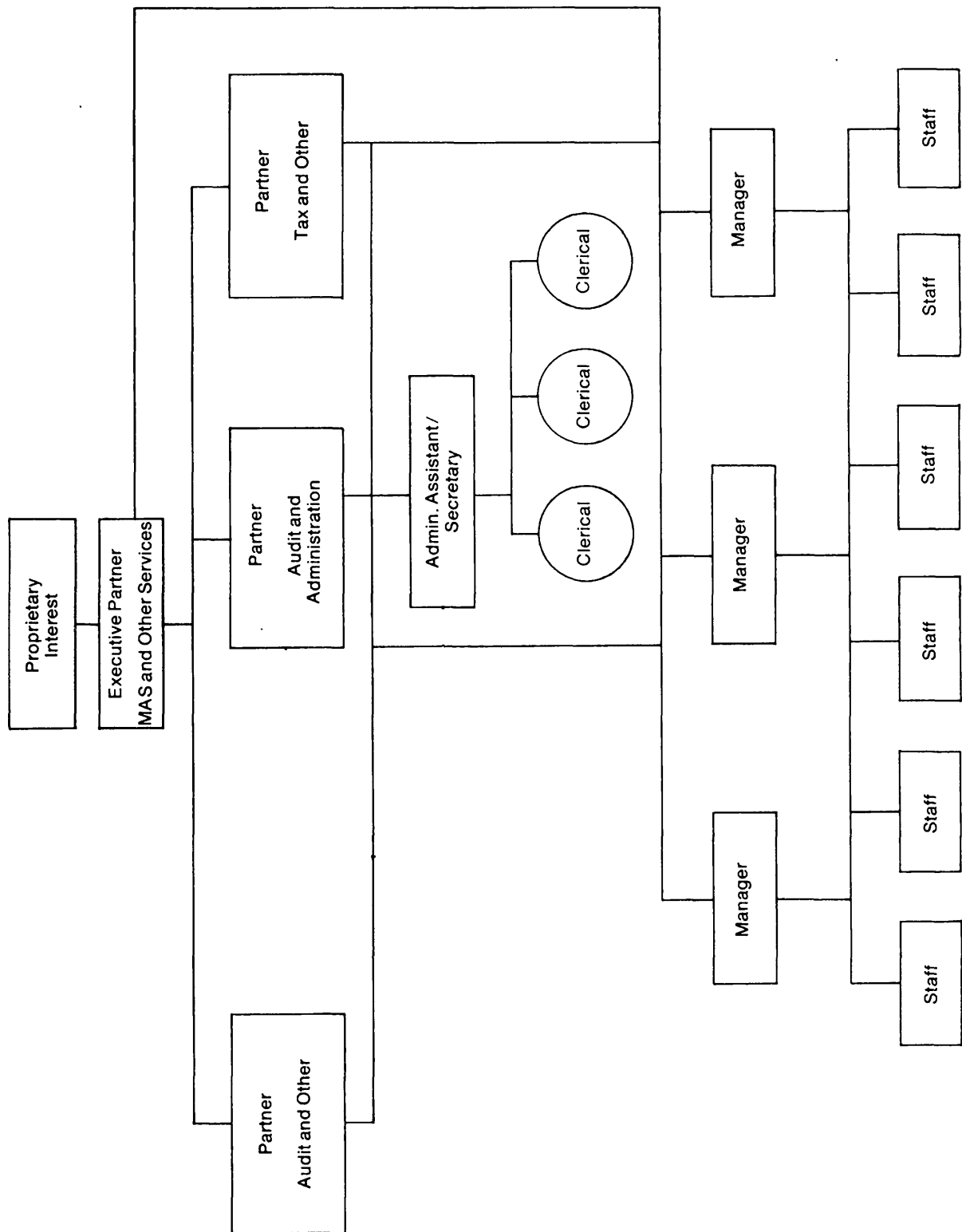
Total man hours expended during the fiscal year ended June 30, 1977, are broken down by the following categories:

Auditing	7,100
Unaudited financial statements	5,400
Taxes	5,400
Management advisory services	2,100
Other accounting services	2,300
	<u>22,300</u>

---

<sup>1</sup> Additional considerations for establishing a firm's stated objectives are discussed in AAM section 11,300.12.



**Organization Chart**

Our practice is conducted from one office and is basically a general practice composed of the following types of clients:

Audit engagements	
Publicly held corporations	1
Manufacturing companies	14
Retail establishments	8
Savings and loan associations	5
Municipalities	3
Unaudited statement engagements	49
Other accounting services	28

Our professional staff (excluding partners) consists of the following:

- 1 Manager with 8 years experience
- 2 Managers with 6 years experience each
- 2 In-charge accountants with 3 years experience each
- 2 Staff assistants with 2 years experience each
- 2 Staff assistants with 1 year experience each
- 1 Part-time intern

All of our full-time staff members are college graduates with a concentration in accounting. One in-charge accountant and all managers are CPAs. The other full-time staff members have passed various parts of the CPA examination.

For the benefit of our professional personnel, an accounting and auditing manual and a personnel manual are maintained. Both manuals are referred to in this document and are, in effect, an integral part of our quality control system.

November 1, 1977

## **.02 Independence**

1. **All personnel are required to adhere to the independence rules, regulations, interpretations, and rulings of the AICPA, (state) CPA Society, (state) Board of Accountancy, state statute, and for applicable engagements, the Securities and Exchange Commission and other regulatory agencies under which we practice.**
  - a. The executive partner is responsible for resolving questions relating to independence matters and is available to provide guidance when required.
  - b. The executive partner communicates with the AICPA and/or the (state) CPA Society for assistance in resolving independence questions that are not satisfactorily resolved within the firm. (See AAM section 11,600.07 for an example of a log which can be utilized to document all communication with parties outside the firm, also see AAM section 11,600.08 for a Consultation Worksheet which can be used to document the subject matter as well as the response from the consultant.)
  - c. A memo documenting the resolution of independence questions is prepared and retained by the executive partner. The other firm personnel involved in the questions review and initial the memo.
2. **Policies and procedures relating to independence are communicated to all personnel.**
  - a. The personnel manual is used to inform personnel of the firm's independence policies and procedures and advise them that they are expected to be familiar with these policies and procedures. Rulings and interpretations of the AICPA, (state) CPA Society, (state) Board of Accountancy, state statute, the Securities and Exchange Commission and other regulatory agencies under which we practice are referred to in the personnel manual.

- b. Independence of mental attitude is emphasized during training sessions and in the supervision and review of engagements.
  - c. Our client list, which is periodically updated, is reviewed by all partners and professional employees to ensure that they are aware of those entities to which our independence policies apply. The executive partner is responsible for maintenance and distribution of the list.
  - d. The firm's library contains professional, regulatory, and firm literature relating to independence matters.<sup>2</sup>
- 3. Independence is confirmed when another firm is engaged to perform a segment of an engagement for which we are the principal auditor.**
- a. The form and content of the independence representation that is to be obtained from a firm that has been engaged to perform segments of an engagement is part of the firm's accounting and auditing manual. (See AAM section 11,600.02.)
  - b. An annual representation of independence should be obtained from an affiliate or associate firm on a repeat engagement.
- 4. Compliance with policies and procedures relating to independence is monitored.**
- a. Confirmations are obtained annually (See AAM section 11,600.01 for an example of an Independence Checklist for Employees.) by the administrative partner from personnel and upon employment from newly hired personnel confirming that—
    - (i) They are familiar with our firm's independence policies and procedures.
    - (ii) Prohibited investments are not held and were not held during the period.
    - (iii) Prohibited relationships do not exist.
    - (iv) Transactions prohibited by the firm have not occurred.
  - b. The executive partner is responsible for the resolution of exceptions to the firm's independence policies and procedures.
  - c. The executive partner designates a partner to perform an annual review each July of the independence compliance files for completeness and the firm's independence policies and procedures for compliance with professional standards. A report of findings is presented to all the partners.
  - d. Accounts receivable that are past due are reviewed monthly by the executive partner to ascertain whether any outstanding amounts take on some of the characteristics of loans and may, therefore, impair the firm's independence.

### **.03 Assigning Personnel to Engagements**

- 1. Our firm's approach to assigning personnel includes the planning of overall firm needs and the measures employed to achieve a balance of engagement manpower requirements, personnel skills, individual development, and utilization.**
- a. On a quarterly basis all partners submit to the administrative partner a projection containing anticipated manpower requirements for engagements during the coming quarter for which they have client responsibilities. (See AAM section 11,600.03 for an example of a form which may be used for this purpose.) Such projections are detailed as to number and classifications of individuals required and are supported by

---

<sup>2</sup> The appropriate information may be found in *AICPA Professional Standards*, Volume 2, in regulation S-X and Accounting Series Releases of the Securities and Exchange Commission, rulings and interpretations of the state CPA societies, the state boards of accountancy, and state statutes.

preliminary engagement time estimates. The administrative partner prepares a summary schedule of assignments to be made for approval by the partners.

- b. For every engagement where the anticipated time exceeds ten man-days, a time budget is normally prepared under the direction of the engagement partner at least a month prior to the scheduled commencement of field work. Time budgets for smaller engagements are prepared as considered necessary by the engagement partners. The budgets provide detail as to appropriate staff level and time required by function such as cash, accounts receivable, inventory, and so forth.
- c. The engagement partner considers the following factors to achieve a balance of engagement manpower requirements, personnel skills, individual development, and utilization:
  - (i) Engagement size and complexity
  - (ii) Personnel availability
  - (iii) Special expertise required
  - (iv) Timing of the work to be performed
  - (v) Continuity and periodic rotation of personnel
  - (vi) Opportunities for on-the-job training

**2. The administrative partner is responsible for assigning personnel to engagements.**

- a. Before the assignment of a professional employee to an engagement, the following criteria are considered:
  - (i) Staffing and timing requirements of the specific engagement.
  - (ii) Evaluations of the qualifications of personnel as to experience, position, background, and any special expertise possessed. (See AAM section 11,600.04.)
  - (iii) The planned extent of supervision and involvement by managers and partners.
  - (iv) Projected time availability of individuals assigned.
  - (v) Situations where possible independence problems and conflicts of interest may exist, such as assignment of personnel to engagements for clients who are former employers or employers of certain kin.
- b. The administrative partner attempts to achieve a balance between the need for continuity and for periodic rotation of personnel by every three years rotating at least one member of the engagement supervisory team (which consists of the in-charge accountant, manager, and engagement partner) off unaudited statement engagements where engagement time exceeds ten man-days during a quarter and all audit engagements. (See AAM section 11,600.05.)

**3. The engagement partner approves the scheduling and staffing of the engagement.**

- a. The names of personnel assigned to an engagement are submitted to the engagement partner for approval.
- b. The engagement partner considers the experience and training of the assigned personnel in relation to complexity or other engagement requirements, and the extent of supervision to be provided.
- c. Unresolved assignment conflicts between an engagement partner and the administrative partner are resolved by the executive partner.

**.04 Consultation**

1. **Areas and specialized situations where consultation is required are identified, and personnel are encouraged to consult with or use authoritative sources on complex or unusual matters.**
  - a. All personnel are advised of our firm's consultation policies and procedures. These policies and procedures are incorporated into the firm's accounting and auditing manual.
  - b. A listing of certain areas or specialized situations, which because of the nature or complexity of the subject have been identified as requiring consultation, is updated semiannually by the administrative partner for inclusion in the accounting and auditing manual. The following areas and situations receive special consideration in preparing the list:
    - (i) Application of newly issued technical pronouncements.
    - (ii) Industries with special accounting, auditing, or reporting requirements.
    - (iii) Emerging practice problems.
    - (iv) Choices among alternative generally accepted accounting principles when an accounting change is to be made.
    - (v) Filing requirements of regulatory agencies.
  - c. A technical reference library is maintained to assist personnel in resolving practice problems. The administrative partner is charged with the responsibility of reviewing semiannually the library contents and making necessary additions.
  - d. Supervisory personnel are encouraged to seek advice from partners and managers the firm has designated as specialists in particular areas when confronted with a situation in the specialist's area of expertise.
  - e. When expertise is not available within the firm, a practice question or problem is referred by the engagement partner to the Technical Information Division of the AICPA or the (state) CPA Society established to handle technical inquiries.
  - f. We maintain a consultation agreement with the local office of (firm name) CPAs to provide our firm with additional expertise. Inquiries to that firm are channeled through the administrative partner.
  - g. The results of outside consultation are reviewed by the engagement partner and the executive partner before a decision is reached on the matter in question.
  - h. An example of a log which can be utilized to maintain a listing of consultations is shown in AAM section 11,600.07. This log can be put in the workpapers to document consultants utilized on the engagement as well as to maintain control for follow-up documentation from the specific consultant used.
  - i. An example of a worksheet which can be used to document the consultations with specialists is shown in AAM section 11,600.08.
2. **Specific individuals are designated as having specialized experience and expertise in certain technical areas. These individuals are available for consultation to all personnel.**
  - a. A listing of firm designated specialists together with their particular expertise is updated semiannually and included in the accounting and auditing manual.
  - b. The following procedures are used to resolve differences of opinion on practice problems:
    - (i) Differences of opinion between a professional employee and an engagement partner are brought before the appropriate designated specialist.

- (ii) If the specialist agrees with the engagement partner, the matter is considered resolved.
  - (iii) If the specialist disagrees with the engagement partner and they are unable to agree on an appropriate resolution, the executive partner is consulted.
  - c. The engagement partner is responsible for the preparation of a memorandum documenting the considerations involved in the resolution of differences of opinion. The original of the memorandum is filed with the engagement working papers and a reference copy without identification of the client is placed in the subject file maintained in the library. Any party to the discussion who disagrees with the conclusion has the option of preparing a memorandum and filing it with the working papers.
3. **In situations where firm policy requires consultation with specialists, a summary of the consultation conclusions and the reasons for the conclusions is required.**
- a. The accounting and auditing manual is used to inform personnel of the extent of documentation required and the responsibility for its preparation. (See AAM section 11,600.07)
  - b. Consultation worksheets (see AAM section 11,600.08) are filed with the engagement working papers, and a copy is placed in the subject file maintained in the library under the supervision of the administrative partner. The subject file is maintained in the event that similar questions arise in connection with the same topics.

## **.05 Supervision**

1. **All engagements are adequately planned by persons knowledgeable about the client and/or the type of engagement.** (For additional information on planning, review AAM section 3000.)
- a. For all annual recurring engagements where the anticipated manpower requirement is in excess of ten man-days, the in-charge accountant or manager reviews with the engagement partner the following documents from the prior year's files (as applicable) to determine if modifications are appropriate:
    - (i) Engagement letter
    - (ii) Time budget compared with actual time expended
    - (iii) Evaluation of the internal control structure
    - (iv) Audit or work program
    - (v) Engagement memorandums
    - (vi) Financial statements and accountant's report
    - (vii) Management letters
  - b. On all engagements in excess of ten man-days, including annual recurring engagements, new engagements, and special engagements, the in-charge accountant or manager submits to the engagement partner the following, where applicable, for his written approval:
    - (i) Engagement letter
    - (ii) Time budget
    - (iii) Preliminary evaluation of the internal control structure
    - (iv) Audit or work program

- (v) A memorandum stating the manpower requirements (including the need for specialized knowledge), current economic conditions affecting the client or its industry, and any other special problems that may have an impact on the conduct of the engagement

**2. Procedures are provided for maintaining the firm's standards of quality for the work performed.**

- a. Depending upon each individual's background in relationship to his assignment, varying degrees of supervision are provided by proper engagement staffing. (See AAM section 11,600.04.)
- b. Each staff member receives an accounting and auditing manual upon joining the firm and is responsible for the proper filing of updates as they are issued. This manual contains examples of properly completed working papers and copies of standardized forms, checklists, and questionnaires.
- c. Differences of opinion among staff members working on an engagement are brought to the attention of the engagement partner. If the partner agrees with the senior party in the dispute, the matter is considered resolved. If no resolution is made, the executive partner is consulted. Any party to the discussion who disagrees with the conclusion has the option of preparing a memorandum and filing it with the working papers.

**3. All engagement working papers and reports are reviewed by appropriate supervisory personnel prior to issuance of the report.** (For additional information on Supervision, review AAM section 9000.)

- a. The in-charge accountant and/or manager reviews and initials all working papers he did not prepare (including those prepared by a partner). The engagement partner reviews the overall engagement (initiating all working papers not reviewed by a manager and working papers dealing with difficult and complex subjects) including financial statements and accountant's report, and discusses with the in-charge accountant or manager any critical audit areas and unusual accounting matters encountered during the course of the engagement. This discussion is documented by a memorandum when appropriate.
- b. In certain circumstances (as enumerated at AAM section 11,300.09 item 1(d)) prior to the issuance of the financial statements and the auditor's report thereon, a second partner not otherwise associated with the engagement evaluates the appropriateness of financial statement disclosures and the auditor's report in relation to the material discussed in the engagement partner's memorandum.

**.06 Hiring**

**1. The firm maintains a program designed to obtain qualified personnel by planning for personnel needs, establishing hiring objectives, and setting qualifications for those involved in the hiring function.**

- a. The administrative partner and the executive partner plan (at least annually) the firm's long-range personnel objectives. Current clientele, anticipated growth, personnel turnover, individual advancement, and retirement are among the factors considered. This plan considers the number and qualifications of personnel as well as the sources and methods for obtaining personnel who meet the requirements and guidelines set by the firm.
- b. The administrative partner is responsible for employment decisions.

**2. Our firm has established qualifications and guidelines for evaluating potential hirees at each professional level.** (See AAM section 11,600.09 for an example of a Pre-Employment Application which can be used to determine the individual's qualifications and AAM section 11,600.10 for an example of an Interview Report which can be used to document the interviewer's comments about individuals interviewed for positions within the firm.)

- a. Our firm seeks to employ individuals who possess high levels of intelligence, integrity, honesty, motivation, and aptitude for the profession.
  - b. Our firm normally employs college graduates with a concentration in accounting as full-time permanent members of our professional staff.
  - c. Newly employed staff members are from the top half of their college class, unless other factors such as personal achievements, work experience, and personal interests indicate the likelihood of adequate professional development.
  - d. Our firm requires that an applicant's academic preparation will enable him to take the CPA examination as administered by the (state) Board of Accountancy.
  - e. The approval of the executive partner is required before making an employment offer in atypical situations, such as hiring relatives of personnel or clients, rehiring former employees, or hiring clients' employees.
  - f. The background of new employees is appropriately investigated to reasonably assure hiring persons with acceptable qualifications, by obtaining completed application forms, college transcripts, and personal references.
  - g. Applicants for positions above entry level are interviewed and approved by the executive partner in addition to the administrative partner before an employment decision is made.
3. **Applicants and new personnel are informed of the firm's policies and procedures relevant to them.**
- a. The firm's personnel policies and procedures relevant to applicants are communicated to them before offers of employment are extended.
  - b. The administrative partner maintains and distributes to all personnel a personnel manual describing policies and procedures.
  - c. The administrative partner discusses the firm's personnel policies and procedures with new employees.

## **.07 Professional Development**

1. **Guidelines and requirements have been established for the firm's professional development program and are communicated to all personnel.**
- a. The administrative partner is responsible for the formulation and implementation of firm policy regarding the guidelines and requirements for the firm's professional development programs.
  - b. As part of their orientation, newly employed personnel are informed of their professional responsibilities and opportunities by the administrative partner.
  - c. Newly employed personnel with limited experience are sent to introductory level training sessions of the AICPA or the (state) CPA Society during their first year of employment with our firm.
  - d. Each partner and professional employee is required to complete a minimum of 40 hours of continuing professional education each year. (Firms should determine the specific requirements of their State Board of Accountancy.) Personnel complete the record of professional development form and forward it to the administrative partner. (See AAM section 11,600.11.) The administrative partner is responsible for having the personnel files of each partner and professional employee updated to include a current record of hours of professional development completed. (See AAM section 11,600.12—.13.) The types of programs qualifying for the fulfillment of the 40-hour requirement include—



- (i) Continuing professional education programs of the AICPA and the (state) Society. This includes both sessions attended and cassette/workbook or workbook programs, as long as there is written evidence of completion.
    - (ii) College courses related to the profession.
  - e. Personnel are reimbursed for membership dues paid to the AICPA, the (state) Society of CPAs and our local chapter of the state society.
  - f. Personnel are encouraged to serve on state society or AICPA committees, write articles for professional publications, serve as discussion leaders at professional development seminars, give speeches, and so forth.
  - g. The executive partner annually reviews the firm's professional development program (including personnel participation records) to determine whether it is adequately meeting the firm's needs, providing for the professional growth of individuals, and meeting mandatory continuing education requirements. An annual report is made to the partners.
- 2. Information about current developments in professional technical standards and materials containing the firm's technical policies and procedures are made available to personnel. Personnel are encouraged to engage in self-development activities.**
- a. It is the responsibility of the administrative partner to distribute statements about current developments in accounting and auditing to all personnel who do not receive them directly. This distribution includes statements and interpretations issued by the Financial Accounting Standards Board and by the AICPA Auditing Standards Board, and so forth.
  - b. Pronouncements relating to areas of specific interest, such as those issued by the Securities and Exchange Commission, Internal Revenue Service, and other regulatory agencies are distributed by the appropriate specialist to persons who have responsibilities in such areas.
  - c. The administrative partner, as the firm's lead technician, is responsible for maintaining an accounting and auditing manual containing firm policies and procedures on technical matters. Updates are prepared and issued to the staff as new developments and conditions arise.
  - d. The firm does not, at present, conduct formal in-house training programs other than in specialized areas. However, from time to time personnel participate in the training programs of (firm name) CPAs.
  - e. A library of staff training cassette/workbook programs published by the AICPA and (state) Society of CPAs is maintained by the administrative partner for self-study and reference purposes and is available to all personnel.
- 3. The firm provides programs to fill its needs for personnel with expertise in specialized areas and industries.**
- a. The administrative partner is responsible for arranging in-house programs on SEC matters, cost accounting, municipal accounting, and savings and loan auditing for personnel involved in these areas.
  - b. Individuals designated as having specialized experience and expertise are encouraged to maintain their proficiency by joining appropriate professional associations and attending external professional education programs.
  - c. The firm will pay for memberships in organizations concerned with specialized areas or industries in which the firm is engaged or intends to become engaged.
  - d. The administrative partner is responsible for maintaining technical literature on specialized areas and industries.

4. The firm recognizes that on-the-job training accounts for a significant part of professional development.
- a. Personnel with in-charge responsibility on engagements—
    - (i) Discuss with assistants the relationship of the work they are performing to the engagement as a whole.
    - (ii) Permit assistants, when practicable, to become involved in areas of the engagement other than those previously assigned.
    - (iii) Explain to assistants the reasons for any additional work requirements discovered through the review process.
  - b. Personnel are evaluated in part on their effectiveness to properly train and develop subordinates.
  - c. The administrative partner monitors assignments to determine that personnel are—
    - (i) Fulfilling, where applicable, the experience requirement of the (state) Board of Accountancy.
    - (ii) Gaining experience in various areas of engagements and varied industries.
    - (iii) Working under different supervisory personnel.

## **.08 Advancement**

1. Our firm has established qualifications deemed necessary for the various levels of responsibility within the firm.
- a. The levels of responsibility that are inherent in the various staff classifications are clearly defined. Our firm has provided for the following staff classifications.<sup>3</sup>
    - (i) Manager
    - (ii) In-charge accountant
    - (iii) Staff assistant
  - b. The criteria which are considered in evaluating individual performance and expected proficiency are enumerated in our staff classification guidelines contained in the personnel manual.
  - c. Our firm's personnel manual provides the staff with information regarding the firm's advancement policies and procedures. The administrative partner issues updates from time to time to reflect changes made by the partnership in the policies and procedures.
2. The performance of our personnel is continuously evaluated, and personnel are periodically advised of their progress. Personnel files are maintained containing documentation relating to the evaluation process.
- a. Professional employees assigned to an engagement for a period in excess of five days must be evaluated by their immediate superior on the engagement by use of an evaluation form. (See AAM section 11,600.14—.15 for examples of Evaluation Forms which may be used for periodic evaluation of staff members. The differences in the forms relate to the amount of time spent on a particular engagement. For example, if a staff member spends 40 or more hours on an engagement a more thorough evaluation can usually be performed (AAM section 11,600.14). AAM section 11,600.16 would be utilized to evaluate the management skills of the individual being evaluated and therefore does not include specific duties

---

<sup>3</sup> The description of the firm's professional levels, with the responsibilities for each level and the general length of time required for advancement to the next position, can be found in AAM section 11,300.11.

relating to the assignment of work performed.) These evaluation forms are reviewed with the employee at the end of the engagement and are approved by the engagement partner.

- b. Personnel are assigned to engagements in a manner that assures they will be reviewed by several people during the course of a year.
- c. Personnel with the responsibility for the preparation of evaluations are counseled (at least annually) by the administrative partner to ensure that they understand the firm's objectives.
- d. All professional employees receive an evaluation of their performance at least once a year. Such counseling interviews are conducted by the administrative partner. These evaluations summarize the evaluations received on engagements during the year. The individual's progress, strengths, weaknesses, future objectives, and the firm's future objectives are among the items discussed. The interviews are documented in each individual's personnel file.
- e. Annually, each partner completes a partner evaluation form evaluating each of the partners, including himself. The completed forms are submitted to the executive partner who summarizes and reviews them with each partner.
- f. The executive partner or his designee reviews (each August) the system of personnel evaluation and counseling to ascertain that—
  - (i) Procedures for evaluation and documentation are being followed on a timely basis.
  - (ii) Requirements established for advancement are being met.
  - (iii) Personnel decisions are consistent with evaluations.
  - (iv) Recognition is given to outstanding performance.

At the completion of the review, a report is made to the partners.

**3. Responsibility for making advancement decisions is assigned to specific individuals.**

- a. The administrative partner is responsible for making advancement and termination recommendations, conducting the evaluation interviews, documenting the results of the interviews, and maintaining appropriate records.
- b. The partners evaluate the above data and, after giving appropriate recognition to the quality of the work performed, make advancement decisions. The executive partner has the ultimate responsibility for making advancement decisions.
- c. The executive partner studies the firm's advancement experience annually to ascertain whether individuals meeting stated criteria are assigned increased degrees of responsibility. A report is made to the partners. This report includes the executive partner's opinion of the capabilities and progress of the staff.

**.09 Acceptance and Continuance of Clients**

- 1. **Our firm has established procedures for evaluation of prospective clients and for their acceptance as clients.** (See AAM section 11,600.18 for a New Client Acceptance Checklist which can be used for prospective clients.)
  - a. Available financial information regarding the prospective client, such as annual reports, interim financial statements, reports to regulatory agencies, and income tax returns is obtained and reviewed. Registration statements and 10-K forms are obtained for public companies.
  - b. Inquiries about potential clients are made to bankers, attorneys, credit services, and others having business relationships with the company.

- c. Predecessor auditors (if applicable) are contacted and inquiries are made in accordance with generally accepted auditing standards.
  - d. Consideration is given to circumstances that would cause the firm to regard the engagement as one requiring special attention or presenting unusual risks. These circumstances include—
    - (i) Audits of publicly held corporations
    - (ii) Audits where the annual fee is expected to exceed \$10,000 or where the expected man-hour requirement exceeds 300 hours
    - (iii) Audits of firms operating in high-risk industries, such as those industries where it is difficult to establish adequate systems of internal control or those industries whose operations are especially sensitive to general economic conditions
    - (iv) Audits of firms in the development stage
    - (v) Audits of firms in serious financial difficulty
    - (vi) Any of the conditions enumerated in 2(a)(iii)
  - e. The firm's independence and ability to adequately serve a potential client are evaluated prior to acceptance. In evaluating the firm's ability, consideration is given to the requirements for technical skills, knowledge of the industry, and availability of qualified personnel.
  - f. A review is made to ensure that acceptance of the client would not violate applicable regulatory agency requirements and the code of professional conduct of the AICPA and/or the (state) CPA Society.
  - g. Procedures for acceptance of a new engagement are as follows:
    - (i) The engagement partner assembles the information and evaluates all matters described in the previous paragraphs.
    - (ii) For all audit engagements, or engagements described in paragraph (d) above, the acceptance is to be approved in writing by the engagement partner and the executive partner.
    - (iii) All other engagements are to be approved in writing by the engagement partner and the administrative partner.
  - h. The administrative partner is responsible for administering the procedures for acceptance of clients. The executive partner performs an annual review for compliance with the firm's policies and procedures for acceptance of clients and makes a report to the partners.
2. **Clients are evaluated at the end of specific periods or upon the occurrence of certain events to determine whether the relationship should be continued.** (See AAM section 11,600.19 for a Client Evaluation Questionnaire which can be used for evaluating existing clients.)
- a. Reevaluations are made of existing clients—
    - (i) Annually, if any of the conditions mentioned in 1(d) above exist.
    - (ii) Every three years if none of the conditions mentioned in 1(d) above exist.
    - (iii) If there is a significant change in one or more of the following:
      - Management
      - Directors
      - Ownership

- Legal counsel
- Financial condition
- Litigation status
- Nature of client's business
- Scope of the auditor's work

(iv) Upon the emergence of conditions that would have caused the firm to reject a client had such conditions existed at the time of the initial acceptance.

- b. The administrative partner is responsible for evaluating the information obtained, making continuance recommendations, and administering firm procedures for continuance of clients. If the administrative partner recommends discontinuance or if any of the conditions enumerated in 2(a)(iii) above or (iv) above exist, all partners participate in the continuance decision.
- c. The executive partner performs an annual review to test for compliance with the firm's policies and procedures for continuance of clients and makes a report to the partners.

## .10 Inspection

1. **The firm conducts an inspection program regarding its quality control policies and procedures.** (See AAM section 11,600.20 for a Summary Inspection Report which can be used to document the results of a firm's yearly quality review inspection and AAM section 11,600.21 for an Inspection of Compliance with Policies and Procedures Relating to Elements of Quality Control.)
  - a. Each year a partner and a manager not otherwise directly involved in firm administration are appointed by the executive partner as an inspection team to evaluate the firm's quality control policies and procedures for compliance with professional standards.
  - b. The appointed partner and manager obtain reasonable assurance that quality control policies and procedures are being complied with by—
    - (i) Inquiring of persons responsible for a function or activity.
    - (ii) Reviewing selected administrative and personnel files.
    - (iii) Reviewing selected engagement working paper files and reports (described below).
    - (iv) Reviewing other evidential matter.
  - c. A sample of engagements is selected annually from each partner's and manager's client listing and is given an in-depth review by the inspection team. The administrative partner reviews engagements of the partner and manager involved in the inspection process to ensure that a representative sample of engagements from all partners and managers has been selected. The working papers and reports are reviewed for compliance with professional standards, including generally accepted auditing standards, generally accepted accounting principles, and the firm's quality control policies and procedures.
  - d. The executive partner annually selects a representative report to be submitted for review to the practice review committee of the (state) Society and/or the AICPA.
  - e. Every third year the firm undergoes an AICPA quality control compliance review, in accordance with the AICPA Quality Control Standards. The executive partner is responsible for scheduling the review and ensuring that all partners participate in the knowledge gained by the reviews.

**2. Provision is made for reporting inspection findings to the appropriate management levels and for monitoring actions taken or planned.**

- a. The results of engagement reviews are discussed with the supervisory personnel responsible for the engagement.
- b. Inspection findings and recommendations are reported to the partners by the inspection team together with corrective actions taken or planned. A memo outlining the findings and recommendations is prepared by the inspection team and is retained by the executive partner.
- c. The executive partner has the responsibility to determine that planned corrective actions were taken and to report the extent of compliance to all the partners.

**.11 Description of the Firm's Professional Levels**

<u>Level</u>	<u>Approximate Time Frame</u>
Staff Assistant	
Level 1	First year (0 to 1)
Level 2	Second year (1 to 2)
In-Charge Accountant	Third, fourth, fifth (3 to 5)
Audit Manager	Sixth through tenth year (6 to 10)
Partner	After the tenth year

*Staff Assistant (Level 1).* A Level 1 staff assistant is expected to—

- Work on portions of audit and accounting engagements.
- Become familiar with the contents of the firm manuals.
- Know the rules, regulations, and code of conduct of the AICPA and the (state) Society of CPAs.
- Be familiar with the pronouncements of the Financial Accounting Standards Board (FASB) and the AICPA, such as the Statements on Auditing Standards (SASs) and Accounting Principles Board Opinions (APBs).
- Progress professionally by working toward passing the CPA examination as soon as possible.

*Staff Assistant (Level 2).* A Level 2 staff assistant should be able to—

- Assume full responsibility under supervision for small accounting engagements involving unaudited financial statements.
- Work on more involved portions of large audit and accounting engagements.
- Prepare financial statements.

*In-Charge Accountant.* An in-charge accountant is expected to—

- Assume full responsibility for small and medium-size audit engagements requiring the services of one or two people and large accounting engagements involving unaudited financial statements.
- Work on (and research) assignments involving “theory” and such “conceptual” areas as materiality and interrelationships of accounts.
- Review and analyze internal control.
- Prepare audit programs and time budgets.

- Prepare management letters.
- Train and supervise the staff assistants assigned to the engagement.
- Recognize, in advance, the possible problem areas of an engagement.
- Pass the CPA examination, if not already certified.

*Manager.* A manager is a CPA and is expected to—

- Assume full responsibility for large audit assignments falling within his expertise.
- Supervise the assignment of duties to, and the training of, personnel assigned to the engagement.
- Supervise a number of engagements at one time.
- In connection with engagements, be responsible for personnel scheduling, compliance with due dates, and monitoring time budgets.
- Adequately review all working papers and the completed reports to ascertain that both meet firm standards.
- Resolve all problems prior to the submission of the report for final partner review.
- Communicate firm policies and technical information to accounting and auditing personnel through individual or group meetings.
- Motivate and assist staff in their professional development.
- Represent the firm in professional and service organizations.
- Develop the firm's reputation and his own through conducting seminars, making speeches, and the like.
- Assist partners with practice development and practice management.

## **.12 Stated Objectives of Firm (Philosophy)**

A particular firm's stated objectives may include items such as the following:

1. Concern for the general public interest.
2. Concern for the financial well-being of clients.
3. Reinvestment of the firm's profits in the training and advancement of the firm's partners and staff.
4. Growth plans for the firm, including opening of branch offices, annual billings, and staff size.
5. Development of specialties such as auditing governmental units or concentration in particular fields—banks, agriculture, retail, and so forth.
6. Development of other services, such as a computer data processing center.
7. Centralization (or decentralization) of authority for issuance of reports.
8. Degree of operating autonomy for individual practice offices.
9. Extent of autonomy for partners.
10. Pattern for firm growth—internal growth through acquisitions of clients and growing apace with them or growth through mergers with other accounting firms.

---

[The next page is 11,401.]

# AAM Section 11,400

## *Sample Quality Control Document for a Sole Practitioner CPA Firm Without Full-Time Staff*

### .01 Firm Background Information

My firm was founded in 1968 after I had gained several years' experience with a local CPA firm. A secretary and a student from the local university are employed on a part-time basis during the busy season.

My objective is to provide quality service in accounting, auditing, income tax, and financial advisory capacities to small businesses in my community. I do not serve publicly held companies, nor do I plan to do so. It is anticipated that the firm's future growth will be through expanded service to present clients and the addition of new clients.<sup>1</sup> I intend to hire and train personnel as needed.

My hours and that of my part-time help were as follows for the past calendar year:

	<u>Myself</u>	<u>Staff</u>	<u>Total</u>
Auditing .....	300	60	360
Unaudited financial statements .....	400	60	460
Taxes .....	900	120	1,020
Other accounting services ...	400	—	400
Total chargeable .....	<u>2,000</u>	<u>240</u>	<u>2,240</u>
Nonchargeable .....	400	—	400
Total hours .....	<u>2,400</u>	<u>240</u>	<u>2,640</u>

My practice is conducted from one office and consists of five audit engagements, for which we are the sole auditors, twelve unaudited financial statement engagements, and fifteen clients for which my firm provides other accounting services. The audit engagements range in time from fifty hours to ninety hours and include three retail establishments and two nonprofit organizations.

May 31, 1978

### .02 Independence

**Any part-time staff and I are required to adhere to the independence rules, regulations, interpretations, and rulings of the AICPA, (state) CPA Society, (state) Board of Accountancy, and state statute.**

- a. I communicate with the AICPA and/or the (state) CPA Society for assistance, if needed, in resolving independence questions. (See AAM section 11,600.07 for an example of a log which can be utilized to document all communication with parties outside the firm. Also, see AAM section 11,600.08 for a Consultation Worksheet which can be used to document the subject matter as well as the response from the consultant.
- b. My part-time staff complete an independence checklist for employees when they are hired. The purpose of the checklist is to determine the part-time staff member's independence and to document the same.
- c. A memorandum documenting the resolution of independence questions is prepared and retained. My part-time employee reviews and initials the memorandum if the question relates to his independence.

<sup>1</sup> Additional considerations for establishing a firm's stated objectives are discussed in AAM section 11,400.11.



- d. Accounts receivable that are past due are reviewed monthly to ascertain whether any outstanding amounts take on some of the characteristics of loans and may, therefore, impair the firm's independence.
- e. Our library contains professional, regulatory, and firm literature relating to independence matters.<sup>2</sup>

### **.03 Assigning Personnel to Engagements**

**Assignment of personnel includes the planning of overall firm needs and the measures employed to achieve a balance of engagement manpower requirements, personnel skills, individual development, and utilization.**

On an annual basis, normally in October of each year, I develop a projection of anticipated manpower requirements to determine if I will need additional staff during the coming year. This is performed by utilizing a "Client History of Staff Assignments" (AAM section 11,600.05) which lists by client the amount of time expended in prior years. (It should be noted that the form in AAM section 11,600.05 can be adapted to be used for a sole practitioner as well as a large firm.)

### **.04 Consultation**

1. **Areas and specialized situations where consultation is required are identified, and personnel are encouraged to consult with or use authoritative sources on complex or unusual matters.**
  - a. A technical reference library is maintained, and I have made arrangements to use the libraries of other practicing CPAs. The AICPA library is also used on a frequent basis.
  - b. When presented with a practice question or problem that I may lack the particular expertise to resolve, I refer to the Technical Information Division of the AICPA or the (state) CPA Society established to handle technical inquiries, or I may confer with another CPA who has expertise in the area.
2. **In those areas and specialized situations where firm policy requires consultation with specialists, a summary of the consultation conclusions and the reasons for the conclusions is required.** (See AAM section 11,600.08.)

Consultation summaries are filed with the engagement working papers. (See AAM section 11,600.07.)

### **.05 Supervision**

1. **All engagements are adequately planned, and procedures are provided for maintaining the firm's standards of quality for the work performed.** (For additional information on Planning, review AAM section 3000.)
  - a. On all recurring engagements, I annually review the following documents from the prior year's files, as applicable, to determine if modifications are appropriate:
    - (i) Engagement letter
    - (ii) Time budget compared with actual time expended
    - (iii) Evaluation of the system of internal control
    - (iv) Audit or work program
    - (v) Engagement notes and memorandums
    - (vi) Financial statement and accountant's report

---

<sup>2</sup> The appropriate information may be found in *AICPA Professional Standards*, volume 2, and in rulings and interpretations of the state CPA societies, the state boards of accountancy, and state statutes.

## (vii) Management letters

The foregoing items are prepared, where applicable, for new and special engagements, and a memorandum is prepared stating special problems, if any, that may have an impact on the conduct of the engagement.

- b. Copies of forms, checklists, and questionnaires are available for use on engagements.
- 2. **All engagement working papers and reports are reviewed prior to issuing the report.** (For additional information on Supervision, see AAM section 9000.)
  - a. I review and initial the work of my part-time employee.
  - b. I review and initial my own work after waiting at least until the following day.
  - c. Checklists are utilized for reviewing engagement working papers and reports.

**.06 Hiring**

- 1. **The firm endeavors to obtain qualified personnel and has established qualifications and guidelines for evaluating potential hires.** (See AAM section 11,600.09 for an example of a Pre-Employment Application which can be used to determine the individual's qualifications and AAM section 11,600.10 for an example of an Interview Report which can be used to document the interviewer's comments about individuals interviewed for positions within the firm.)
  - a. During my busy season, I normally employ a college senior who has completed substantially all of the accounting curriculum course requirements for graduation.
  - b. I interview potential employees and appropriately investigate their backgrounds to reasonably assure our hiring persons with acceptable qualifications.
- 2. **New personnel are informed of the firm's policies and procedures relevant to them.**

A copy of this quality control document is presented to newly hired personnel.

**.07 Professional Development**

- 1. **I have an annual professional development requirement.**
  - a. I am a member of the AICPA and the (state) CPA Society and participate in professional activities.
  - b. I complete a minimum of 40 hours of formal continuing professional education each year in areas related to my practice. (Firms should determine the specific requirements of their State Board of Accountancy.) A record of professional development hours is maintained, updated, and periodically reviewed. (See AAM section 11,600.11.) The types of programs qualifying for the fulfillment of the forty-hour requirement include—
    - (i) Continuing professional education programs of the AICPA and the (state) CPA Society. These include sessions attended and, with written evidence of completion, cassette/workbook, or workbook programs.
    - (ii) College courses related to the profession.
- 2. **Information about current developments in professional technical standards and materials containing the firm's technical policies and procedures are made available to personnel.**

I receive and review statements relating to current developments in accounting and auditing including statements and interpretations issued by the Financial Accounting Standards Board, the AICPA Auditing Standards Board, and other AICPA technical committees.

**3. On-the-job training accounts for a significant part of professional development.**

I provide for on-the-job training by discussing with my part-time employee the relationship of his work to the engagement as a whole. Also, during my review of working papers prepared by my part-time employee, I explain the need for any additional work requirements discovered through the review process.

**.08 Advancement**

**The element of advancement is inapplicable because the firm uses only part-time staff.**

**.09 Acceptance and Continuance of Clients**

**1. Procedures are established for evaluation of prospective clients and for their acceptance as clients.** (See AAM section 11,600.18 for a New Client Acceptance Checklist which can be used for prospective clients.)

- a. I obtain and review available financial information regarding the prospective client (such as annual and interim financial statements and income tax returns).
- b. I make inquiries about potential clients to bankers, attorneys, credit services, and others having business relationships with the company.
- c. I contact predecessor auditors, where applicable, and make inquiries in accordance with generally accepted auditing standards.
- d. I consider circumstances that would cause the firm to regard the engagement as one requiring special attention or presenting unusual risks. These circumstances include the following:
  - (i) Audits where the annual fee is expected to exceed \$2,500 or where the expected man-hour requirement exceeds seventy-five hours
  - (ii) Audits of firms operating in high-risk industries, such as those industries where it is difficult to establish adequate systems of internal control or those industries whose operations are especially sensitive to general economic conditions
  - (iii) Audits of firms in the development stage
  - (iv) Audits of firms in serious financial difficulty
  - (v) Audits of firms experiencing change in any of the following: management or ownership, legal counsel, financial condition, litigation status, nature of business, or scope of engagement
- e. I evaluate the firm's independence and ability to adequately serve a potential client. In evaluating the firm's ability, I give consideration to the requirements for technical skills, knowledge of the industry, and personnel.
- f. A review is made to ensure that acceptance of the client would not violate applicable regulatory agency requirements and the code of professional conduct of the AICPA and/or the (state) CPA Society.
- g. I assemble, evaluate, and document the items listed above before making an acceptance decision.

**2. Clients are evaluated at the end of specific periods or upon the occurrence of certain events to determine whether the relationship should be continued.** (See AAM section 11,600.19 for a Client Evaluation Questionnaire which can be used for evaluating existing clients.)

## a. Reevaluations of existing clients are made—

(i) Annually, if any of the conditions mentioned in 1(d) above exist.

(ii) Every three years if none of the conditions mentioned in 1(d) above exist.

(iii) If there is a significant change in one or more of the following:

- Management or ownership
- Legal counsel
- Financial condition
- Litigation status
- Nature of client's business
- Scope of engagement

(iv) Upon the emergence of conditions that would have caused me to reject a client had such conditions existed at the time of the initial acceptance.

## b. I prepare an annual memorandum documenting the evaluations.

**.10 Inspection**

1. **The firm conducts an inspection program regarding its quality control policies and procedures.** (See AAM section 11,600.20 for a Summary Inspection Report which can be used to document the results of a firm's yearly quality review inspection and AAM section 11,600.21 for an Inspection of Compliance With Policies and Procedures Relating to Elements of Quality Control.)

Each year, I evaluate the firm's quality control policies and procedures for compliance with professional standards by use of AICPA and/or (state) Society checklists. This procedure includes a review of administrative, personnel, and engagement files sufficient to obtain reasonable assurance that quality control policies and procedures are being complied with.

2. **The firm adheres to the quality control standards that have been established by the AICPA.**

Every three years there is a quality review of the firm's accounting and auditing practice. This review is performed by either a peer firm qualified to perform the review or a team assembled for the review purpose.

3. **Provision is made for reporting inspection findings and for monitoring actions taken or planned.**

I evaluate inspection findings and recommendations together with suggested corrective actions and prepare and retain a memorandum documenting that the inspection has been performed. Appropriate corrective actions, if any, are taken.

**.11 Stated Objectives of Firm (Philosophy)**

A particular firm's stated objectives may include items such as the following:

1. Concern for the general public interest.
2. Concern for the financial well-being of clients.
3. Reinvestment of the firm's profits in the training and advancement of personnel.
4. Growth plans including opening of branch offices, annual billings, and staff size.

5. Development of specialties such as auditing governmental units or concentration in particular fields—agriculture, retail, and so forth.
  6. Development of other services such as a computer data processing center.
  7. Pattern for firm growth—internal growth through acquisitions of clients and growing apace with them or growth through mergers with other accounting firms.
- 

[The next page is 11,501.]

# AAM Section 11,500

## *Sample Quality Control Document for a Sole Practitioner CPA Firm With Full-Time Staff*

### .01 Firm Background Information

The firm was founded in 1972 after the proprietor gained several years' experience with a local CPA firm. Presently, our full-time staff consists of two professional employees and a secretary. One per diem accountant is hired during the busy season. An accounting student and a secretary are available on a part-time basis, as needed.

The firm's objectives are to—

- Provide high-quality accounting, auditing, tax, and management advisory services to growth-oriented companies in our geographic area.
- Serve clients with outstanding business potential and to help each company reach its maximum potential through sound and efficient accounting, financial, and management advice.
- Be actively involved in professional, business, community, and civic affairs.
- Offer close, personalized service on a timely basis.

In order to achieve these goals and objectives, the firm seeks to grow through a combination of expanded service to present clients and the addition of new clients on a regular basis.<sup>1</sup>

Total hours billed during the year ending December 31, 1977, were as follows:

Auditing	1,400
Unaudited financial statements	1,950
Taxes	2,200
Other accounting services	1,050
Total hours	<u>6,600</u>

Our practice is conducted from one office, and our audit clientele, for which our firm is the sole auditor, consists of six retail establishments, three manufacturing companies, three service companies, and two nonprofit organizations. In addition, we have twenty-eight unaudited statements clients and twenty clients for whom we provide other accounting services.

Both of our full-time professional staff members joined our firm upon graduation from college. One of the staff members has been with our firm for four years and the other, for one year.

May 31, 1978

### .02 Independence

1. All personnel are required to adhere to the independence rules, regulations, interpretations, and rulings of the AICPA, (state) CPA Society, (state) Board of Accountancy, and state statutes.

- a. Mr. (practitioner) is responsible for resolving questions relating to independence matters and is available to provide guidance when required.

---

<sup>1</sup> Additional considerations for establishing a firm's stated objectives are discussed in AAM section 11,500.11.

- b. Mr. (practitioner) communicates with the AICPA and/or the (state) CPA Society for assistance in resolving independence questions that are not satisfactorily resolved within the firm. (See AAM section 11,600.07 for an example of a log which can be utilized to document all communication with parties outside the firm. Also see AAM section 11,600.08 for a Consultation Worksheet which can be used to document the subject matter as well as the response from the consultant.
- c. A memorandum documenting the resolution of independence questions is prepared and retained by Mr. (practitioner); the other firm personnel review and initial the memorandum if the question relates to their independence.

**2. Policies and procedures relating to independence are communicated to all personnel.**

- a. Memorandums are used to inform personnel of the firm's independence policies and procedures and advise them that they are expected to be familiar with those policies and procedures. Rulings and interpretations of the AICPA, (state) CPA Society, (state) Board of Accountancy, and state statutes are also made available to personnel.
- b. An independent mental attitude is emphasized during the conduct of engagements.
- c. I review the current client listing with each new employee to ensure that the employee is aware of those entities to which independence policies apply. During the monthly staff meeting, the staff is informed of any changes in the listing.
- d. Our library contains professional, regulatory, and firm literature relating to independence matters.<sup>2</sup>

**3. Compliance with policies and procedures relating to independence is monitored.**

- a. Annually, all staff members are required to complete a questionnaire (see AAM section 11,600.01), indicating that—
  - (i) They are familiar with the firm's independence policies and procedures.
  - (ii) They are not now nor have been holding prohibited investments.
  - (iii) They are not now nor have been involved in relationships or transactions that are prohibited.
- b. Mr. (practitioner) is responsible for the resolution of exceptions to the firm's policies and procedures relating to independence.
- c. Accounts receivable that are past due are reviewed monthly by Mr. (practitioner) to ascertain whether any outstanding amounts take on some of the characteristics of loans and may, therefore, impair the firm's independence.

**.03 Assigning Personnel to Engagements**

- 1. **Our firm's approach to assigning personnel includes the planning of overall firm needs and the measures employed to achieve a balance of engagement manpower requirements, personnel skills, individual development, and utilization.**
  - a. On an annual basis, normally in September of each year, Mr. (practitioner) develops a projection containing anticipated manpower requirements for the next year. (See AAM section 11,600.06.)
  - b. In scheduling assignments, Mr. (practitioner) strives to achieve a balance of engagement manpower requirements, personnel skills, individual development, and utilization, taking into consideration—

---

<sup>2</sup> The appropriate information may be found in *AICPA Professional Standards*, Volume 2, and in rulings and interpretations of the state CPA societies, the state boards of accountancy, and state statutes.

- (i) Engagement size and complexity
- (ii) Personnel availability
- (iii) Special expertise required
- (iv) Timing of the work to be performed

- 2. Mr. (practitioner) is responsible for assigning personnel to engagements.** (See AAM section 11,600.04—.05 for examples of forms which can be used to facilitate assigning personnel to specific engagements.)
- a. Before the assignment of a professional employee to an engagement, Mr. (practitioner) considers the nature of the engagement, personnel availability, extent of supervision required, and possible independence problems or conflicts of interest.
  - b. To the extent practicable, Mr. (practitioner) attempts to achieve a balance between the need for continuity and for periodic rotation of staff.

#### **.04 Consultation**

- 1. Areas and specialized situations where consultation is required are identified, and personnel are encouraged to consult with or use authoritative sources on complex or unusual matters.**
- a. All personnel are advised of our firm's consultation policies and procedures. These policies and procedures are set forth in a memorandum.
  - b. Certain areas or specialized situations have been identified as requiring consultation because of their nature or complexity. They include the following:
    - (i) Application of newly issued technical pronouncements.
    - (ii) Industries with special accounting, auditing, or reporting requirements.
    - (iii) Emerging practice problems.
    - (iv) Choices among alternative generally accepted accounting principles when an accounting change is to be made.
  - c. A technical reference library is maintained, and arrangements have been made to use the libraries of other practicing CPAs. The resources of the AICPA library are drawn upon when needed.
  - d. When expertise is not available within the firm, practice questions and problems are referred by Mr. (practitioner) to the Technical Information Division of the AICPA or the (state) CPA Society established to handle technical inquiries.
  - e. We maintain a consultation agreement with the local office of (firm name), CPAs, to provide us with additional expertise. Inquiries to that firm are channeled through Mr. (practitioner).
- 2. In those areas and specialized situations where firm policy requires consultation with specialists, a summary of the consultation conclusions and the reasons for the conclusions are required.**
- a. The consultation policy memorandum is used to inform personnel of the consultation procedures, the extent of documentation required, and the responsibility for its preparation.
  - b. Consultation worksheets (see AAM section 11,600.08) are filed with the engagement working papers.

#### **.05 Supervision**



1. **All engagements are adequately planned.** (For additional information on Planning, review AAM section 3000.)
  - a. On all annual recurring engagements, the staff accountant reviews with Mr. (practitioner) (or Mr. (practitioner) reviews alone) the following documents from the prior year's files, as applicable, to determine if modifications are appropriate:
    - (i) Engagement letter
    - (ii) Time budget compared with actual time expended
    - (iii) Evaluation of the internal control structure
    - (iv) Audit or work program
    - (v) Engagement notes and memorandums
    - (vi) Financial statements and accountant's report
    - (vii) Management letters
  - b. For all engagements (including annual recurring engagements, new engagements, and special engagements), the staff accountant submits to Mr. (practitioner) the following, where applicable, for his written approval, or Mr. (practitioner) prepares, where applicable, the following:
    - (i) Engagement letter
    - (ii) Time budget
    - (iii) Preliminary evaluation of the internal control structure
    - (iv) Audit or work program
    - (v) A memorandum stating the special problems, if any, that may have an impact on the conduct of the engagement
2. **Procedures are provided for maintaining the firm's standards of quality for the work performed.**
  - a. Depending upon each individual's background in relation to his assignment, varying degrees of supervision are provided.
  - b. Copies of forms, checklists, and questionnaires are available for use on engagements.
  - c. Differences of opinion among staff members working on an engagement are resolved by Mr. (practitioner). Any party to the discussion who disagrees with the conclusion has the option of preparing a memorandum and filing it with the working papers.
3. **All engagement working papers and reports are reviewed prior to issuance of the report.** (For additional information on Supervision, review AAM section 9000.)
  - a. The staff accountant reviews and initials all working papers he did not prepare (excluding those prepared by Mr. (practitioner)).
  - b. Mr. (practitioner) reviews the overall engagement (including his own working papers after waiting at least one day following their preparation) by completing a review checklist.

## **.06 Hiring**

1. **The firm endeavors to obtain qualified personnel by planning for personnel needs and establishing hiring objectives.**

- a. Mr. (practitioner) annually plans the firm's long-range personnel objectives. Current clientele, anticipated growth, personnel turnover, individual advancement, and retirement are among the criteria considered.
  - b. Mr. (practitioner) makes the employment decisions.
- 2. Our firm has established qualifications and guidelines for evaluating potential hirees.** (See AAM section 11,600.09 for an example of a Pre-Employment Application which can be used to determine the individual's qualifications and AAM section 11,600.10 for an example of an Interview Report which can be used to document the interviewer's comments about individuals interviewed for positions within the firm.)
- a. Our firm seeks to employ individuals with high levels of intelligence, integrity, honesty, motivation, and aptitude for the profession.
  - b. Our firm normally employs college graduates with a concentration in accounting as full-time permanent members of its professional staff. The following general criteria are considered in hiring decisions:
    - (i) Academic background
    - (ii) Personal achievements
    - (iii) Work experience
    - (iv) Personal interests
  - c. Our firm normally expects that an applicant's academic preparation will enable him to take the CPA examination as administered by the (state) Board of Accountancy.
  - d. The backgrounds of potential employees are appropriately investigated to reasonably assure our hiring persons with acceptable qualifications by obtaining completed application forms, college transcripts, personal references, and employment references.
  - e. Potential employees are interviewed by Mr. (practitioner) who informs them about the firm.
- 3. New personnel are informed of the firm's policies and procedures relevant to them.**
- a. Mr. (practitioner) discusses the firm's personnel policies and procedures with new employees.
  - b. A copy of this quality control document is presented to newly hired personnel.

## **.07 Professional Development**

- 1. Guidelines and requirements have been established for the firm's professional development program and are communicated to all personnel.**
- a. Mr. (practitioner) and any eligible staff are members of the AICPA and the (state) CPA Society; they also participate in professional activities.
  - b. Mr. (practitioner) is responsible for the formulation and implementation of guidelines and requirements for professional development.
  - c. As part of their orientation, new employees are informed of professional responsibilities and opportunities by Mr. (practitioner).
  - d. Mr. (practitioner) and the full-time professional employees are required to complete a minimum of 40 hours of formal continuing professional education each year. (Firms should determine the specific requirements of their State Board of Accountancy.) Personnel complete the record-of-professional-development form (see AAM section 11,600.11) and forward it to Mr. (practitioner). He reviews the form

and has it filed in the individual's personnel file. The types of programs qualifying for the fulfillment of the 40-hour requirement include—

- (i) Continuing professional education programs of the AICPA and the (state) CPA Society. This includes sessions attended and, with written evidence of completion, cassette/workbook or workbook programs.
  - (ii) College courses related to the profession.
- e. Mr. (practitioner) annually reviews and approves the firm's professional development program (including personnel participation records) to determine whether it is adequately meeting the firm's needs, providing for the professional growth of individuals, and meeting mandatory continuing education requirements. (See AAM section 11,600.12—.13.)

**2. Information about current developments in professional technical standards and materials containing the firm's technical policies and procedures are made available to personnel. Personnel are encouraged to engage in self-development activities.**

It is the responsibility of Mr. (practitioner) to distribute statements relating to current developments in accounting and auditing to all personnel not receiving them directly. This includes statements and interpretations issued by the Financial Accounting Standards Board, the AICPA Auditing Standards Board, and other AICPA technical committees.

**3. The firm recognizes that on-the-job training accounts for a significant part of professional development.**

- a. Mr. (practitioner) provides for on-the-job training by discussing with the engagement staff the relationship of the work they are performing to the engagement as a whole. Also, during the review of working papers prepared by staff members, the proprietor explains the need for any additional work requirements discovered through the review process.
- b. When practicable, professional employees are assigned to varying engagement areas.
- c. Assignments are monitored to determine that personnel are fulfilling, where applicable, the experience requirements of the (state) Board of Accountancy.

**.08 Advancement**

**1. The performance of our personnel is continuously evaluated, and personnel are periodically advised of their progress. Personnel files are maintained containing documentation of the evaluation process.**

- a. At least annually, all professional employees receive an evaluation of their performance. (See AAM section 11,600.14—.15 for examples of Evaluation Forms which may be used for periodic evaluation of staff members. The differences in the forms relate to the amount of time spent on a particular engagement. For example, if a staff member spends 40 or more hours on an engagement a more thorough evaluation can usually be performed (AAM section 11,600.14). AAM section 11,600.16 would be utilized to evaluate the management skills of the individual being evaluated and therefore does not include specific duties relating to the assignment of work performed.) Such counseling interviews are conducted by Mr. (practitioner). These evaluations summarize performance on engagements during the year. The individual's progress, strengths, weaknesses, future objectives, and the firm's future objectives are among the items discussed.
- b. Results of evaluations are documented in the individual's personnel file.

**2. Mr. (practitioner) makes advancement and termination decisions and documents the results.**

**.09 Acceptance and Continuance of Clients**

- 1. Our firm has established procedures for evaluation of prospective clients and for their acceptance as clients.** (See AAM section 11,600.18 for a New Client Acceptance Checklist which can be used for prospective clients.)
  - a. Available financial information regarding the prospective client (such as annual and interim financial statements and income tax returns) is obtained and reviewed.
  - b. Inquiries about potential clients are made to bankers, attorneys, credit services, and others having business relationships with the company.
  - c. Where applicable, predecessor auditors are contacted, and inquiries are made in accordance with generally accepted auditing standards.
  - d. Consideration is given to circumstances that would cause the firm to regard the engagement as one requiring special attention or presenting unusual risks. These circumstances include the following:
    - (i) Audits where the annual fee is expected to exceed \$3,000 or where the expected man-hour requirement exceeds ninety hours
    - (ii) Audits of firms operating in high-risk industries, such as those industries where it is difficult to establish adequate internal control structures or those industries whose operations are especially sensitive to general economic conditions
    - (iii) Audits of firms in the development stage
    - (iv) Audits of firms in serious financial difficulty
    - (v) Audits of firms experiencing change in any of the following: management or ownership, legal counsel, financial condition, litigation status, nature of business, or scope of engagement
  - e. The firm's independence and ability to adequately serve a potential client are evaluated prior to its acceptance. In evaluating the firm's ability, consideration is given to the requirements for technical skills, knowledge of the industry, and personnel.
  - f. A review is made to ensure that acceptance of the client would not violate applicable regulatory agency requirements and the codes of professional conduct of the AICPA and/or the (state) CPA Society.
  - g. Mr. (practitioner) assembles, evaluates, the documents the applicable foregoing considerations before making an acceptance decision.
- 2. Clients are evaluated at the end of specific periods or upon the occurrence of certain events to determine whether the relationship should be continued.** (See AAM section 11,600.19 for a Client Evaluation Questionnaire which can be used for evaluating existing clients.)
  - a. Reevaluations of existing clients are made—
    - (i) Annually, if any of the conditions mentioned in 1(d) above exist.
    - (ii) Every three years if none of the conditions mentioned in 1(d) above exist.
    - (iii) If there is a significant change in one or more of the following:
      - Management or ownership
      - Legal counsel
      - Financial condition

- Litigation status
- Nature of client's business
- Scope of engagement

(iv) Upon the emergence of conditions that would have caused the firm to reject a client had such conditions existed at the time of the initial acceptance.

- b. Based on the information obtained, Mr. (practitioner) makes the continuance decision and documents it with a memorandum.

## **.10 Inspection**

1. **The firm conducts an inspection program regarding its quality control policies and procedures.** (See AAM section 11,600.20 for a Summary Inspection Report which can be used to document the results of a firm's yearly quality review inspection and AAM section 11,600.21 for an Inspection of Compliance With Policies and Procedures Relating to Elements of Quality Control.)

Using AICPA and/or (state) Society checklists, Mr. (practitioner) annually evaluates the firm's quality control policies and procedures for compliance with professional standards. This procedure includes a review of administrative, personnel, and engagement files sufficient to obtain reasonable assurance that quality control policies and procedures are being complied with.

2. **The firm adheres to the quality control standards that have been established by the AICPA.**

Every three years there is a quality review of the firm's accounting and auditing practice. This review is performed by either a peer firm qualified to perform the review or a team assembled for the review purpose.

3. **Provision is made for reporting inspection findings and for monitoring actions taken or planned.**

Mr. (practitioner) evaluates the inspection findings and recommendations together with suggested corrective actions and prepares and retains a memorandum documenting that the inspection has been performed. Appropriate corrective actions, if any, are taken.

## **.11 Stated Objectives of Firm (Philosophy)**

A particular firm's stated objectives may include items such as the following:

1. Concern for the general public interest.
2. Concern for the financial well-being of clients.
3. Reinvestment of the firm's profits in the training and advancement of personnel.
4. Growth plans including opening of branch offices, annual billings, and staff size.
5. Development of specialties such as auditing governmental units or concentration in particular fields—agriculture, retail, and so forth.
6. Development of other services such as a computer data processing center.
7. Pattern for firm growth—internal growth through acquisitions of clients and growing apace with them or growth through mergers with other accounting firms.

---

[The next page is 11,601.]

# AAM Section 11,600

## Sample Quality Control Forms

### .01 Independence Checklist for Employees

Office \_\_\_\_\_

Employee name \_\_\_\_\_

In order to determine that the firm and its employees are in compliance with the independence rules, regulations, interpretations and rulings of the AICPA, the State CPA Society, the State Board of Accountancy, and state statutes the following must be completed by \_\_\_\_\_ (date) and returned to \_\_\_\_\_ as noted at the end of the form. If there are any questions you have related to the completion of the form, or if there is a matter that has come to your attention which may impair the firm's independence, please contact Mr. J. Partner to resolve the problem.

	Yes	No
1. Do you have a direct or indirect material financial interest in a client* or its subsidiaries and affiliates?	_____	_____
2. Do you have a financial interest in any major competitors, investees, or affiliates of a client*?	_____	_____
3. Do you have any outside business relationship with a client* or an officer, director, or principal stockholder having the objective of financial gain?	_____	_____
4. Do you owe any client* an amount, except a normal consumer note payable or home mortgage made by a financial institution under normal lending procedures, terms, and requirements?	_____	_____
5. Do you have a note or account receivable from a client*, except for a deposit in a financial institution?	_____	_____
6. Do you have the authority to sign checks for a client*?	_____	_____
7. Are you connected with a client* as a promoter, underwriter or voting trustee, director, officer or in any capacity equivalent to a member of management or an employee?	_____	_____
8. Do you serve as a director, trustee, officer, or employee of a nonprofit organization that is a present client*?	_____	_____
9. Has your spouse or minor child been employed by a client*?	_____	_____
10. Has anyone in your legal family, or any blood relative, been employed in any type of managerial position by a client*?	_____	_____
11. Are any billings delinquent for clients* that are your responsibility?	_____	_____

I have read the Firm's Independence Policy and AICPA standards. I believe I understand the independence policy and standards. I am in compliance except for the exceptions listed below. (Exceptions to policies: A "No" answer to the independence checklist is an exception. Give details as to names, addresses, amounts (relationships of amounts to your net worth is relevant), etc. Leaving the space blank indicates you have no exceptions.)

---

\* Client. The enterprise with whose financial statements the member is associated.

Arrangements made to dispose of above exceptions to comply with policies:

_____ Signature	_____ Date	_____ Reviewer's initials
_____ Exceptions approved by	_____ Location	

Instructions: Sign and return to \_\_\_\_\_ within one week after starting work. Annually, a new form must be completed during the first week of September.

**.02 Independence and Representation Checklist for Other Auditors**

Office \_\_\_\_\_

Firm name \_\_\_\_\_

In order to determine that your firm is in compliance with the independence standards, regulations, interpretations and rulings of the AICPA, the State CPA Society, the State Board of Accountancy, and state statutes the following must be completed by \_\_\_\_\_ (date) and returned to \_\_\_\_\_ as noted at the end of the form. If there are any questions you have related to the completion of the form, or if there is a matter that has come to your attention which may impair your firm's independence, please contact Mr. J. Partner to resolve the problem.

	<u>Yes</u>	<u>No</u>
1. We are aware that <u>(Name of primary auditor)</u> has been engaged to audit the financial statements of <u>(Name of parent)</u> as of <u>(Date)</u> and for the <u>(period, e.g., year)</u> then ended.	_____	_____
2. We are aware that <u>(Name of primary auditor)</u> plans to rely on our audit of the financial statements of <u>(Name of subsidiary or component)</u> as of <u>(Date)</u> and for the <u>(period, e.g., year)</u> then ended.	_____	_____
3. [We are aware that the primary auditor will refer to our report in their report.]	_____	_____
4. We are independent with respect to <u>(Name of both the parent and subsidiary or component).</u>	_____	_____

\_\_\_\_\_  
Partner of other audit firm\_\_\_\_\_  
Date

Reviewed by:

\_\_\_\_\_  
Partner of primary audit firm



**.03 Scheduling Request**

Client \_\_\_\_\_ Engagement No. \_\_\_\_\_ Year End \_\_\_\_\_

Partner \_\_\_\_\_ Manager \_\_\_\_\_ Tax Ptr/Mgr \_\_\_\_\_

Personnel Requested	Experience Level	Interim			Year End			Total Hours
		From	Thru	Hours	From	Thru	Hours	
_____	_____	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____	_____

Audited? Yes\_\_\_\_ No\_\_\_\_

SEC? Yes\_\_\_\_ No\_\_\_\_

Industry \_\_\_\_\_

Estimated total hours:

Partner \_\_\_\_\_

Manager \_\_\_\_\_

Staff \_\_\_\_\_

Total \_\_\_\_\_

Can dates be adjusted? Yes\_\_\_\_ No\_\_\_\_ Explain \_\_\_\_\_

Can personnel be changed? Yes\_\_\_\_ No\_\_\_\_ Explain \_\_\_\_\_

Comments \_\_\_\_\_

Requested by \_\_\_\_\_ Date \_\_\_\_\_ Scheduled \_\_\_\_\_ Date \_\_\_\_\_

Assignment  
Manager

**.04 History of Staff Assignments**

NAME \_\_\_\_\_

<u>CLIENT/ LOCATION</u>	<u>DATES</u>		<u>RESPONSIBILITY LEVEL</u>	<u>TOTAL HOURS</u>	<u>ASSIGNMENT DESCRIPTION</u>			<u>REPORTED TO</u>
	<u>INTERIM</u>	<u>YEAR END</u>			<u>INDUSTRY</u>	<u>SEC</u>	<u>AUDIT AREAS PERFORMED</u>	
_____	_____	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____	_____
_____	_____	_____	_____	_____	_____	_____	_____	_____

[illegible]

**.06 Scheduling Master Plan**

MONTH OF \_\_\_\_\_

Staff member	Carry forward	Month assignments	Nonworking hours							Nonrecurring assignments				Hours for month		
			Vacation	Holiday	Prof. dev.	Comp time	CPA exam	Admin	Other	Tax dept	Review dept	Other client #	hr	Total assign	Available	(Over) under
Aston	XX	XX	XX	X	X		X					XXXXXX	X	XXX	X	XX
Barry	XX	X	XX	X	X			X	X					XXX	XX	X
Casey	X	X	X	X					X	X				XXX	XX	XX
Davis	XX	X	X	X	X	X	X	X	X	X	X	XXXXXXXX	XX	XXXX	XX	(XX)
Evans	X	X	X	X	X	X						XXXXXXXX	XX	XXXX		(XX)
Frank	XX	X	X	X	X	X	X	X	X	X	X	XXXXXXXX	XX	XXXX	X	(XX)
Louis	XX	X	XX	X	X	X		X		X				XXX	XX	XX
Miceli	XX	X	XX	XX	X	X	X	X						XXX	XX	XX
Total	XXXX	XX	XXX	XXX	XX	XX	XX	XX	XX	XX	XX		XXX	XXX	XXX	XXX

[illegible]

**.08 Consultation Worksheet**

DATE\_\_\_\_\_

CLIENT NAME\_\_\_\_\_

ENGAGEMENT\_\_\_\_\_

CONSULTANT\_\_\_\_\_

SUBJECT\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

CONSULTANT (Cite professional literature discussed and conclusion of consultant)\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

RESOLUTION\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_

\_\_\_\_\_  
Senior/Manager

\_\_\_\_\_  
Date

\_\_\_\_\_  
Partner

\_\_\_\_\_  
Date

<b>.09 PRE-EMPLOYMENT APPLICATION</b>					
NAME					DATE
ADDRESS					
TELEPHONE NUMBER			SOCIAL SECURITY NUMBER		
<b>POSITION APPLIED FOR</b>					
FIRST CHOICE		SECOND CHOICE		MINIMUM SALARY REQUIRED: \$	
<input type="checkbox"/> Full Time <input type="checkbox"/> Permanent Part Time <input type="checkbox"/> Temporary <input type="checkbox"/> Summer Temporary					
REFERRED BY <input type="checkbox"/> Newspaper ad _____ NAME _____ <input type="checkbox"/> Agency _____ NAME _____ <input type="checkbox"/> Friend _____ NAME _____ <input type="checkbox"/> Other _____ NAME _____					
<b>EDUCATIONAL BACKGROUND —</b> <input type="checkbox"/> See Below <input type="checkbox"/> See Attached Resume					
	NAME & LOCATION OF SCHOOL	MAJOR COURSE	YEARS ATTENDED		YEAR GRAD.
			FROM	TO	
Elementary					
High or Vocational					
Business or Technical					
College					
Graduate					
<b>ADDITIONAL SKILLS OR MACHINE KNOWLEDGE</b> <input type="checkbox"/> See Below <input type="checkbox"/> See Attached Resume					

NOTE: See exhibit 304-2 of the AICPA MAP Handbook for an alternative.

**AAM § 11,600.09**



.10	INTERVIEW REPORT	DAY _____ DATE _____ TIME _____
NAME OF APPLICANT _____		
POSITION APPLIED FOR _____		
COMMENTS BY INTERVIEWER:           		
RECOMMENDED ACTION:		
INTerviewed By: _____ TITLE: _____		
PLEASE RETURN TO HUMAN RESOURCES AS SOON AS POSSIBLE		

NOTE: See exhibit 303-6 of the AICPA MAP Handbook for an alternative.

**.11 Record of Professional Development**

Name \_\_\_\_\_ Employee No. \_\_\_\_\_

**Out-of-Office Courses:**

	<u>Sponsor</u>	<u>Course description</u>	<u>No. of hours</u>	<u>Date completed</u>
1.	_____	_____	_____	_____
2.	_____	_____	_____	_____
3.	_____	_____	_____	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____
7.	_____	_____	_____	_____
8.	_____	_____	_____	_____
9.	_____	_____	_____	_____
10.	_____	_____	_____	_____

**In-House Programs:**

	<u>Instructor</u>	<u>Course description</u>	<u>No. of hours</u>	<u>Date completed</u>
1.	_____	_____	_____	_____
2.	_____	_____	_____	_____
3.	_____	_____	_____	_____
4.	_____	_____	_____	_____
5.	_____	_____	_____	_____
6.	_____	_____	_____	_____
7.	_____	_____	_____	_____
8.	_____	_____	_____	_____
9.	_____	_____	_____	_____
10.	_____	_____	_____	_____

**.12 19XX Professional Development****Summary (in hours)****In-house presentations**

	<b><u>Developed in-house</u></b>	<b><u>Purchased programs</u></b>	<b><u>Outside courses</u></b>	<b><u>Total</u></b>
<b>Partners/Owners</b>				
1. _____	_____	_____	_____	_____
2. _____	_____	_____	_____	_____
3. _____	_____	_____	_____	_____

**In-house presentations**

	<b><u>Developed in-house</u></b>	<b><u>Purchased programs</u></b>	<b><u>Outside courses</u></b>	<b><u>Total</u></b>
<b>Professional staff</b>				
1. _____	_____	_____	_____	_____
2. _____	_____	_____	_____	_____
3. _____	_____	_____	_____	_____
4. _____	_____	_____	_____	_____
5. _____	_____	_____	_____	_____
6. _____	_____	_____	_____	_____
7. _____	_____	_____	_____	_____
8. _____	_____	_____	_____	_____
<b>Paraprofessionals</b>				
1. _____	_____	_____	_____	_____
2. _____	_____	_____	_____	_____
3. _____	_____	_____	_____	_____
4. _____	_____	_____	_____	_____

**.13 19XX Professional Development****Summary (in dollars)**

	<b><u>Purchased programs for in-house use</u></b>	<b><u>Outside courses</u></b>	<b><u>Total</u></b>
<b>Partners/Owners</b>			
1. _____	\$ _____	\$ _____	\$ _____
2. _____	_____	_____	_____
3. _____	_____	_____	_____
<b>Professional staff</b>			
1. _____	_____	_____	_____
2. _____	_____	_____	_____
3. _____	_____	_____	_____
4. _____	_____	_____	_____
5. _____	_____	_____	_____
6. _____	_____	_____	_____
7. _____	_____	_____	_____
8. _____	_____	_____	_____
<b>Paraprofessionals</b>			
1. _____	_____	_____	_____
2. _____	_____	_____	_____
3. _____	_____	_____	_____
4. _____	_____	_____	_____

**.14 Performance Evaluation***(To be completed after each engagement of forty hours or more.)*

Name \_\_\_\_\_ Classification \_\_\_\_\_

Client \_\_\_\_\_ From \_\_\_\_\_ To \_\_\_\_\_

Describe work assigned: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

In your opinion based on the staff member's classification, should this assignment be considered:

Demanding ☐Routine ☐This individual is ☐ is not ☐ ready for increased responsibility. Explain \_\_\_\_\_  
\_\_\_\_\_**Rating:** Enter comments which describe the staff member's performance on this engagement. Rate the staff member on each of the items below as Outstanding (O), Very High (VH), Good (G), Below Normal (BN), or Not Applicable (NA).*(Support each caption with specific incidents or remarks.)***Technical Knowledge:** Did the staff member possess adequate technical knowledge to function effectively at the level assigned? Did this knowledge encompass accounting principles, auditing standards, and tax accounting? Has the staff member kept current on recent developments and new pronouncements on professional practice matters as they affected this engagement?Rating: ☐ O ☐ VH ☐ G ☐ BN ☐ NA  
☐ ☐ ☐ ☐ ☐**Analytical  
Ability  
and Judgment:**

How well did the staff member recognize problems, develop relevant facts, formulate alternative solutions, and decide on appropriate conclusions? Did the staff member distinguish between material and immaterial items? Was the staff member practical in adapting theory and experience to the individual circumstances of this client?

Rating: ☐ O ☐ VH ☐ G ☐ BN ☐ NA  
☐ ☐ ☐ ☐ ☐**Written and Oral  
Expression:**

Evaluate the effectiveness of the staff member's letters, memoranda, and other forms of written communication. In conversation, did the staff member communicate intentions effectively? Were instructions understood the first time? Did the staff member sell ideas, obtain acceptance and action?

Rating: ☐ O ☐ VH ☐ G ☐ BN ☐ NA  
☐ ☐ ☐ ☐ ☐

NOTE: See exhibit 307-7 of the AICPA MAP Handbook for an alternative.

**Performance:**

Can you depend on the staff member for sustained, productive work? Were assignments organized and completed accurately in a reasonable amount of time? Did the staff member readily assume responsibility? Did the staff member meet time estimates and document work papers properly?

Rating: ☐ O ☐ VH ☐ G ☐ BN ☐ NA  
☐ ☐ ☐ ☐ ☐

---



---



---

**Development of Personnel:**

In assigning work, did the in-charge staff member make the most effective use of available talent in terms of getting the work done and in terms of developing staff members performing the work? Did the in-charge staff member tend to make assignments which were either too easy or too hard for his subordinates? Was the staff member readily accepted as a leader? Was the staff member effective in on-the-job coaching?

Rating: ☐ O ☐ VH ☐ G ☐ BN ☐ NA  
☐ ☐ ☐ ☐ ☐

---



---



---

**Client Relations:**

How well did the staff member relate to this client and gain his acceptance? How well did the staff member recognize and take advantage of practice development opportunities, through extension of services to this client?

Rating: ☐ O ☐ VH ☐ G ☐ BN ☐ NA  
☐ ☐ ☐ ☐ ☐

---



---



---

**Attitude:**

Did the staff member demonstrate a positive and professional approach to the assignment? Was this demonstrated by sustained effort in completing work? Was the assignment undertaken with enthusiasm and zest? Did the staff member respond in a positive way to suggestions and guidance from superiors? To what degree did the staff member make personal sacrifices to meet client requirements? Was the staff member a helpful member of the team? Did the staff member go out of his way to help an associate?

Rating: ☐ O ☐ VH ☐ G ☐ BN ☐ NA  
☐ ☐ ☐ ☐ ☐

---



---



---

**Personal Characteristics:**

Did the staff member possess self-confidence and was this confidence projected in an acceptable way? Were positive impressions created with this client and with associates? Did the staff member have a keen sense of what to do or say (tact)? Were clothes appropriate to professional work? Was the staff member well groomed?

Rating: ☐ O ☐ VH ☐ G ☐ BN ☐ NA  
☐ ☐ ☐ ☐ ☐

---



---



---

Strong points which were evident: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Recommendations for improvement: \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

Comments of Staff Member Being  
Evaluated: \_\_\_\_\_

\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

**Signatures:**

Evaluated staff member \_\_\_\_\_ Date \_\_\_\_\_

Evaluator \_\_\_\_\_ Title \_\_\_\_\_ Date \_\_\_\_\_

Engagement manager \_\_\_\_\_ Date \_\_\_\_\_

Partner \_\_\_\_\_ Date \_\_\_\_\_

.15

**JOB EVALUATION REPORT**  
**[For Assignments of Thirty (30) Hours or More]**

Name \_\_\_\_\_

Location \_\_\_\_\_

Engagement \_\_\_\_\_

Assistant \_\_\_\_\_ In-Charge \_\_\_\_\_

**A. PERFORMANCE ON THE JOB****1. Technical Ability Demonstrated**

- a) The purpose of the audit procedures planned was understood .....
- b) Materiality was neither underestimated nor overestimated .....
- c) Accounting theory and current releases of the profession were applied correctly .....
- d) Federal and state income tax regulations were applied correctly .....

**2. Working Paper Evidence**

- a) Documentation of work performance, including adequate indexing and cross referencing ...
- b) Sound explanations and conclusions .....
- c) Use of standard work papers .....
- d) Legibility .....
- e) Accuracy — absence of mathematical errors .....

**3. Completing This Job**

- a) Meeting planned time estimates .....
- b) Completing reports and tax returns .....
- c) Following up the reviewer's comments and making the necessary changes .....

**4. Client Reaction on This Job**

- a) Getting along with the client's employees .....
- b) Interest in the client's business .....

**B. ENGAGEMENT ADMINISTRATION — (For In-Charge Accountants Only)****1. Effectiveness of Proper Planning**

- a) Extent that the scope of the work related to internal control .....
- b) Developing the work program .....

**2. Utilizing Staff Effectively and Efficiently**

- a) Advance planning to minimize crises .....
- b) Efficient use of staff on the job .....
- c) On-the-job training of assistants .....

**3. Meeting Deadlines**

- a) Completing the engagement in the planned time .....
- b) Delivering completed pencil copies of the report and tax returns to the supervisor as agreed .....

**4. The Product**

- a) Quality of report preparation, including adequate and informative disclosures .....
- b) Quality of the management advice recommendations .....

**5. Practice Management**

- a) Extending services .....
- b) Ease of collecting for services performed .....

Compared to Others in Peer Group						
A	A-	B+	B	B-	C+	C
SUPERIOR						
EXCELLENT						
ABOVE AVERAGE						
SATISFACTORY						
IMPROVEMENT DESIRED						
IMPROVEMENT REQUIRED						
UNSATISFACTORY						
NOT APPLICABLE						



## Knowledge and Skill Form

**(and Profile of Management Role Performance)**

(Complete Annually)

Time Period Involved		.17 EMPLOYEE ANNUAL PERFORMANCE APPRAISAL	<input type="checkbox"/> EXEMPT <input type="checkbox"/> NON-EXEMPT	
From	To			
Name		Position Title	Number	
Hire Date	Present Position Date	Days Absent From: _____ To: _____ Charged To Sick Time: _____ Disability: _____		
Strengths		Development Needs		
		Suggested Plan for Performance Improvement		
Summary				
Overall Rating on Having Met Job Requirements				
Non-Exempt - Circle One			Exempt - Circle One	
1	2	3	1	2
1 = Did Not Meet Job Requirements			1 = Did Not Meet Job Requirements 2 = Met Most	
2 = Met All 3 = Exceeded			3 = Met All 4 = Exceeded 5 = Far Exceeded	

Review the following questions before answering them, using the following criteria:

- A "yes" answer should be considered for possible mention as a "strength". If so, refer to it on the first page of this evaluation.
- A "no" answer should be considered for possible mention as a "development need". If so, refer to it on the first page of this evaluation.

All answers should be considered in arriving at an overall rating on having met job requirements.

	CHECK AS APPROPRIATE				Development Need
	Strength	Yes	N/A	No	
<u>Quality of Work</u>					
Is work accurate, neat and clearly presented?	( )	( )	( )	( )	( )
Carefully planned, well organized and thorough?	( )	( )	( )	( )	( )
<u>Productivity</u>					
Is a good level of production maintained?	( )	( )	( )	( )	( )
Are deadlines met?	( )	( )	( )	( )	( )
Are pressure situations handled effectively?	( )	( )	( )	( )	( )
<u>Knowledge of Job</u>					
Does the individual know where to get information?	( )	( )	( )	( )	( )
Is the individual used as a source of information by others?	( )	( )	( )	( )	( )
<u>Communication</u>					
Does the individual ask for clarification when necessary?	( )	( )	( )	( )	( )
Does the individual respond to others in a manner that indicates understanding?	( )	( )	( )	( )	( )
Are ideas expressed so that others are able to understand them?	( )	( )	( )	( )	( )
<u>Human Relations</u>					
Does the individual cooperate with others to get the job done?	( )	( )	( )	( )	( )
Does the individual demonstrate tact and courtesy in dealing with others?	( )	( )	( )	( )	( )
Does the individual maintain a good working relationship with all others?	( )	( )	( )	( )	( )
Are questions and requests dealt with in a helpful manner?	( )	( )	( )	( )	( )
<u>Need for Supervision</u>					
Can the individual be relied upon to get work done without close supervision?	( )	( )	( )	( )	( )
Does the individual take the initiative when appropriate?	( )	( )	( )	( )	( )

	CHECK AS APPROPRIATE				
	Strength	Yes	N/A	No	Development Need
<u>Problem Solving</u>					
Does the individual collect the data needed to solve problems?	( )	( )	( )	( )	( )
Are problems solved quickly?	( )	( )	( )	( )	( )
Are solutions reasonable and accurate?	( )	( )	( )	( )	( )
Does the individual know when to ask for advice and whom to ask?	( )	( )	( )	( )	( )
Does the individual seek out methods to do work more efficiently?	( )	( )	( )	( )	( )
Are alternate solutions generated when appropriate?	( )	( )	( )	( )	( )
<u>Work Habits</u>					
Does the individual comply with the Institute's established work hours?	( )	( )	( )	( )	( )
Does the individual provide proper notification when absent from work?	( )	( )	( )	( )	( )
<u>Personal Development</u>					
Does the individual try to expand on required knowledge and skills?	( )	( )	( )	( )	( )
Does the individual readily grasp and master the new job requirements?	( )	( )	( )	( )	( )
Does the individual show ambition by building on strengths and working on deficiencies?	( )	( )	( )	( )	( )
Is the individual a good candidate for promotion?	( )	( )	( )	( )	( )
Is the individual ready for promotion at this time?	( )	( )	( )	( )	( )
<u>Supervisory Capabilities</u>					
Does the individual demonstrate the ability to direct and be responsible for the performance of others?	( )	( )	( )	( )	( )
Does the individual effectively evaluate and develop subordinates?	( )	( )	( )	( )	( )
Are subordinates properly motivated?	( )	( )	( )	( )	( )
Are subordinates given reasonable goals and aided in meeting them?	( )	( )	( )	( )	( )
Does the individual comply with administrative and policy guidelines of ?	( )	( )	( )	( )	( )
Is good judgment exercised in observing budget constraints?	( )	( )	( )	( )	( )
Does the individual maintain adequate discipline in regard to subordinates attendance and punctuality?	( )	( )	( )	( )	( )
Does the individual provide a good example for peers and subordinates to follow?	( )	( )	( )	( )	( )

## INCUMBENT REVIEW COMMENTS &amp; ACKNOWLEDGEMENT

I acknowledge that: (1) I have reviewed and discussed this performance appraisal with the preparer. My signature means that I have been advised of my performance evaluation but does not necessarily imply that I agree with it; (2) I have received a copy of the goals/duties that will be used to evaluate my performance during the coming year; and (3) I have reviewed my job description and do ☐ do not ☐ feel it should be revised. My signature and the date I discussed this with the preparer appears below.

Employee	Date
Evaluator/Title	Date

**.18 New Client Acceptance Checklist**

Name of prospective client: \_\_\_\_\_

Address and Phone No.: \_\_\_\_\_  
\_\_\_\_\_Name and title of contact at prospective client: \_\_\_\_\_  
\_\_\_\_\_

Form completed by: \_\_\_\_\_ Date: \_\_\_\_\_

**Instructions**

This form provides for information necessary to assess whether to accept prospective client. The information should be obtained from discussions with the prospective client's management, banker, attorney, and if applicable current or former independent CPA, from reviewing the client's financial statements and tax returns, and from other sources such as industry or accounting journals, etc. As much information as possible should be obtained before visiting the potential client. Depending on the type of engagement involved, some information requested on this form may not be applicable, or additional information may be necessary and should be attached.

**Services and Reports Required**

1. Describe the service and reports requested. \_\_\_\_\_  
\_\_\_\_\_
2. Describe the reason the service is needed, including any regulatory requirements or third parties for which the service or report is intended. \_\_\_\_\_  
\_\_\_\_\_
3. What is the required completion date? \_\_\_\_\_
4. Describe any other services not requested for which there appears to be a need. \_\_\_\_\_  
\_\_\_\_\_

**Industry Practices and Conditions**

5. In what industry does the company operate? \_\_\_\_\_  
\_\_\_\_\_
6. Describe any specialized tax or accounting practices applicable to the industry. \_\_\_\_\_  
\_\_\_\_\_
7. Describe any economic, technological or competitive conditions or other recent developments in the industry that may affect the company's operations. \_\_\_\_\_  
\_\_\_\_\_
8. Describe any special regulatory requirements applicable to the industry. \_\_\_\_\_  
\_\_\_\_\_

**Organization and Personnel**

9. Company's Legal Name: \_\_\_\_\_ Fiscal Year End: \_\_\_\_\_
10. Type of legal entity (Corporation, S Corporation, partnership, proprietorship, etc.): \_\_\_\_\_  
\_\_\_\_\_

11. List the major stockholders (partners or owners) of the company and their percentage of ownership. If applicable, obtain and attach a copy of the company's organization chart.

Name and (if applicable) Title	% Ownership
_____	_____
_____	_____
_____	_____

12. List the principal members of management.

Name and Title	Stated Qualifications (education, training, and experience)
_____	_____
_____	_____
_____	_____

13. Briefly describe any existing or contemplated employee bonus arrangement (individual, title, method of computation), stock option, or pension (profit sharing) plans that may affect the engagement.

\_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

14. List each location maintained by the company (including foreign locations, if any) the nature of the activity performed at each, and the approximate number of employees at each, i.e., plant, sales office, executive offices, etc.

Location	Activity	No. of Employees
_____	_____	_____
_____	_____	_____

15. Inquire about possible transactions with related parties that may affect the engagement.

Name of Related Party	Relationship	Type of Transaction
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____
_____	_____	_____

### Operations

16. Describe the nature of the company's major assets and liabilities. \_\_\_\_\_

\_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

17. What are the company's sources of revenue and marketing methods? Describe major products, customers, etc.) \_\_\_\_\_

\_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

18. If the company is economically dependent on a major customer, name the customer and approximate percentage of total revenue generated by this customer. \_\_\_\_\_

\_\_\_\_\_  
 \_\_\_\_\_  
 \_\_\_\_\_

19. Describe the components of cost of goods sold and the company's production process. \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_
20. What are the major expenses of the company other than cost of good sold? \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_
21. Describe the company's compensation methods, i.e., salary, hourly wage, commissions, piece work, union scale, etc. \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_
22. What are the company's major sources of financing, i.e., working capital loans, long term debt, leasing, equity, etc. Describe restrictive covenants on any loan agreements. \_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

### Accounting

23. Does the company maintain the following items? (Attach description, if appropriate.)
- a. Accounting manual? \_\_\_\_\_
  - b. Budget? \_\_\_\_\_
  - c. Cost accounting system? \_\_\_\_\_
  - d. EDP equipment? (indicate type of equipment and software) \_\_\_\_\_  
\_\_\_\_\_
  - e. Written credit policy? \_\_\_\_\_



24. Briefly describe the accounting system and accounting responsibilities.

Description of Accounting Record	Name of person who is responsible	EDP	MANUAL	N/A
General Ledger				
Subsidiary Ledgers:				
Accounts receivable				
Fixed assets				
Loans payable				
Accounts payable				
Perpetual inventory				
Physical inventory summarization				
Journals:				
Cash receipts				
Cash disbursements				
Sales/purchase/voucher				
Payroll				
General journal entries				
Financial Reporting				
(Indicate basis of accounting):				
Annual financial statements				
Monthly financial statements				
Management reports				
Other:				
Bank reconciliations				

25. Describe the company's completeness procedures and methods to insure that accounting transactions enter into the accounting system, i.e., that all shipments or services are invoiced, that all cash sales are recorded, and that all disbursements are recorded.

---



---



---



---



---

26. Describe any unusual features of the accounting system.

---



---



---

27. For audit engagements, does it appear that the accounting system provides accounting records sufficient to permit the application of audit procedures on a cost-effective basis? (If no, attach a memo explaining the possible scope limitation, its potential effect on the auditor's report, and the potential management's reaction.)

---



---



---

**Tax Matters**

28. Who prepares the tax returns?\_\_\_\_\_
29. Describe major differences between book and tax income, unusual tax elections, carry forwards or IRS examinations in process. If possible, review copies of the most recent 3 years of tax returns and attach them to this form.\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

**Other Matters**

30. Describe any significant problems that could affect the engagement, such as litigation or other contingencies, unusual agreements, and plans to acquire or dispose of significant assets, merge with another entity, enter a new area of business, convert to or expand use of EDP equipment, etc.\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_
31. Give the name of a current or former independent CPA.\_\_\_\_\_  
a. Describe any disputes over accounting matters.\_\_\_\_\_  
\_\_\_\_\_
32. Describe any apparent problems or areas for improvement that were noted where our firm could provide additional service or recommendations.\_\_\_\_\_  
\_\_\_\_\_  
\_\_\_\_\_

**Independence**

33. Would service to this client cause problems of independence or conflicts of interest because of relationships with other clients or members of the staff?\_\_\_\_\_  
\_\_\_\_\_

**Fees**

34. Based on inquiries with a current or former independent CPA, if applicable, indicate the amount of any unpaid fees and the reason for nonpayment.\_\_\_\_\_  
\_\_\_\_\_
35. If possible indicate the amount of fees charged by an existing or former independent CPA for the service being proposed. (The CPA or the potential client may be willing to furnish this information, or it might be obtainable from the financial statements or tax return.)\_\_\_\_\_  
\_\_\_\_\_
36. Describe any other indications that our firm might have a problem billing or collecting our fees.\_\_\_\_\_  
\_\_\_\_\_

**Management Integrity**

37. Have any of the following sources raised any concerns about management's integrity?
- a. Difficulty in obtaining information from management, or evasive, guarded or glib responses to inquiries.\_\_\_\_\_  
\_\_\_\_\_
  - b. Apparent difficulty in meeting financial obligations or a deteriorating financial position that might predispose management to make an intentional error, irregularity or misrepresentation.
  - c. Disputes about accounting principles, engagement procedures or similarly significant matters with an existing or former accountant, or doubts of the predecessor accountant about management's integrity.\_\_\_\_\_  
\_\_\_\_\_

- d. Comments by bankers, attorneys, creditors, or others having a business relationship with the potential client. \_\_\_\_\_
38. If management is changing accountants, why is the change being made? \_\_\_\_\_
39. Is there any reason to suspect that management would be uncooperative, unreasonable or otherwise unpleasant to work with? \_\_\_\_\_

**Other Comments or Observations**

40. Give any other comments or observations that might affect our decision whether to prepare a proposal letter or its contents. Add attachments to this form, if necessary. \_\_\_\_\_

**.19 Client Evaluation Questionnaire****CONFIDENTIAL**Client \_\_\_\_\_ Account Director \_\_\_\_\_  
Date \_\_\_\_\_*(Circle only one number in each group.)***What is usual condition of client's records?**

- 2 Unusable or always late
- 4 Scattered but workable
- 6 Client needs orientation
- 8 Good
- 10 Excellent

**What is client's potential growth?**

- 5 Terminating
- 10 Decreasing
- 15 Level
- 20 Growing
- 25 Unlimited

**What is client's attitude toward IRS?**

- 1 Apprehensive
- 2 Hostile
- 5 Apathetic
- 8 Cooperative

**What work is done for client?**

- 3 Bookkeeping
- 6 Unaudited reports
- 9 Opinion audits
- 12 Year-end work and special services
- 15 Comprehensive services

**Does client pay fees on time?**

- 1 May never pay
- 2 Always 90 days late
- 5 Pays within 45 days
- 10 Pays when billed

**How does client react to fees?**

- 1 Fees always challenged as too high
- 5 Requires itemized bill
- 10 Usually accepts amount of bill
- 15 Wants service and expects to pay
- 20 Thinks we are superior—pays premium

**What is the total annual fee?**

- 3 To \$1,500
- 6 \$1,500—\$5,000
- 9 \$5,000—\$10,000
- 12 Above \$10,000

**What is client's attitude toward recommending us?**

- 1 Would never do so
- 2 Might do so
- 12 Has not recently
- 16 Does at times
- 20 Does frequently

**What does client want from us?**

- 1 Minimum service
- 2 Security regarding IRS
- 3 Counseling
- 4 Timely service
- 5 Direction and tax planning

**From whom does client seek information?**

- 1 His employees
- 2 News media
- 3 His competitors
- 4 His friends
- 5 Professionals (including us)

**What is client's attitude toward his expenses?**

- 1 Spendthrift
- 2 Niggardly
- 3 Economical
- 4 Liberal
- 5 Goes "first class"

**Does client expose us to legal action?**

- 1 High risk
- 2 Would consider suit
- 3 Low risk
- 4 Little risk
- 5 Would never sue

**What is client's attitude toward our staff?**

- 1 Critical and argumentative
- 2 Uncooperative
- 3 Usually cooperative
- 4 Businesslike
- 5 Friendly and appreciative

**What is client's financial strength?**

- 1 Insolvent
- 4 Solvent but undercapitalized
- 8 Adequate
- 10 Strong capital structure

Above conditions prevailed at month of \_\_\_\_\_

Evaluation by \_\_\_\_\_

**Scoring:**

Maximum = 154 points

Minimum = 23 points

30 points and below = Drop client

30 to 50 points = Evaluate in 90 days (on trial)

50 to 70 points = Make an attempt to upgrade client

70 points and above = Retain client

Total Points \_\_\_\_\_

*Make additional comments on back.*

**.20 Summary Inspection Report****I. Planning the Inspection**

A. Inspection period \_\_\_\_\_

B. Composition of Inspection Team:

1. Captain \_\_\_\_\_ Position \_\_\_\_\_

2. Team Member \_\_\_\_\_ Position \_\_\_\_\_

3. Team Member \_\_\_\_\_ Position \_\_\_\_\_

C. Indicate matters that may require additional emphasis in the inspection and explain why.

---

---

---

---

D. Development of Inspection Program:

1. Describe programs used and indicate any deviations therefrom.

---

---

---

---

2. Describe basis for selection of engagements:

---

---

---

E. Timing of Inspection:

Commencement \_\_\_\_\_

Completion of field work \_\_\_\_\_

Issuance of report \_\_\_\_\_

**II. Scope of Work Performed**

A. Indicate elements of quality control not addressed and give reasons.

---

---

---

---

## B. Engagements Reviewed:

	Firm Totals		Engs. Reviewed	
	Hrs.	No. of Engs.	Hrs.	No. of Engs.
Audits:				
SEC Clients				
Government <sup>1</sup>				
Other				
Reviews				
Compilations				
Other Accounting Services				
Percentage of A&A Practice Reviewed				
Comments:				

III. *Engagement Conclusions*

A. Did the inspection disclose any situation that led the reviewers to conclude that the firm or office should consider:

1. Taking action to prevent future reliance on a previously issued report, pursuant to SAS No. 1 (AU section 561)? Yes \_\_\_\_\_ No \_\_\_\_\_
2. Performing additional auditing procedures to provide a satisfactory basis for a previously expressed opinion, pursuant to SAS No. 46 (AU section 390)? Yes \_\_\_\_\_ No \_\_\_\_\_

B. Did the inspection team conclude in any instances that the firm or office lacked a reasonable basis under the standards for accounting and review services for the report issued? Yes \_\_\_\_\_ No \_\_\_\_\_

If any of the answers above are yes, attach a description of such situations, including actions the firm or office has taken or plans to take.

IV. *Findings and Recommendations:*

Attach a copy of any reports issued, including a summary of any inspection findings and recommendations for improvement or list such findings and recommendations below.

---



---



---



---



---



---

Supervisory Partner \_\_\_\_\_  
Date \_\_\_\_\_<sup>1</sup> Includes only audits conducted pursuant to the Single Audit Act of 1984.

**.21 Inspection of Compliance With Policies and Procedures Relating to the Elements of Quality Control**

<u>Period Covered</u>	<u>Yes</u>	<u>No</u>	<u>N/A</u>	<u>Extent of Testing</u>
<u>INDEPENDENCE</u>				
1. Have memorandums of inquiry, written representations, or other appropriate documentation been obtained, evidencing:				
a) Communication of firm policies and procedures relating to independence?	—	—	—	—
b) Monitoring of compliance with those policies and procedures?	—	—	—	—
2. Have independence questions which have arisen been appropriately resolved and, where necessary, have appropriate authorities been consulted?	—	—	—	—
<u>ASSIGNING PERSONNEL TO ENGAGEMENTS</u>				
1. Have the firm's policies and procedures been followed to provide reasonable assurance that personnel are assigned to engagements in a manner that attempts to achieve a balance between the complexity of the engagement, the qualifications of the staff and individual development?	—	—	—	—
<u>CONSULTATION</u>				
1. Does the firm's reference library contain technical manuals, and recent pronouncements, including those relating to particular industries and other specialties, that meet the needs of the practice?	—	—	—	—
2. On engagements reviewed, was consultation made and documented in accordance with firm policy?	—	—	—	—
3. If sufficient testing of consultation policies and procedures was not performed in 2 above, were consultations that took place appropriately and correctly applied? (This may be accomplished through inquiry or review of the subject files.)	—	—	—	—
<u>SUPERVISION</u>				
1. On engagements reviewed, have the required technical materials, (audit manuals, standardized forms, checklists and questionnaires) been used?	—	—	—	—
2. Based on the engagements reviewed:				
a) Are the technical materials sufficiently comprehensive and up-to-date?	—	—	—	—
b) Are the firm's policies and procedures for the review of engagement working papers, reports and financial statements appropriate?	—	—	—	—



	<u>Yes</u>	<u>No</u>	<u>N/A</u>	<u>Extent of Testing</u>
c) Are the firm's procedures for resolving differences of opinion among members of the engagement team appropriate?	_____	_____	_____	_____
<u>PROFESSIONAL DEVELOPMENT</u>				
1. Do the firm's professional development records meet the requirements of the firm and of the Section?	_____	_____	_____	_____
2. Has the professional development program for the last year been reviewed to determine if it fulfills the firm's needs for personnel with expertise in specialized areas and industries?	_____	_____	_____	_____
<u>HIRING</u>				
1. Has the firm planned for its personnel needs in accordance with its policies and procedures?	_____	_____	_____	_____
2. Does the firm's hiring program satisfy its needs?	_____	_____	_____	_____
3. Do personnel files of recently hired employees contain appropriate evidence that the individuals meet the firm's personal, educational, and experience requirements?	_____	_____	_____	_____
4. Have new personnel been notified of the policies and procedures that apply to them?	_____	_____	_____	_____
<u>ADVANCEMENT</u>				
1. Based on a review of personnel files, personnel evaluations, or other documentary evidence, have personnel been evaluated and promoted in accordance with the firm's policies and procedures?	_____	_____	_____	_____
<u>ACCEPTANCE AND CONTINUANCE OF CLIENTS</u>				
1. Do new client files contain documentation of compliance with the firm's policies and procedures for acceptance of clients?	_____	_____	_____	_____
2. On engagements reviewed, was the firm's policy for continuance of clients, including required documentation, complied with?	_____	_____	_____	_____
<u>INSPECTION</u>				
1. Were appropriate corrective actions taken, including effective follow-up, with respect to the prior period's inspection findings?	_____	_____	_____	_____
_____ Reviewer	_____ Date			
_____ Supervisory Partner	_____ Date			

AAM

APPENDIXES

Pronouncements cited in the Audit and Accounting Manual are cross-referenced to sections in the text

TABLE OF CONTENTS  
Cross-References

American Institute of Certified Public Accountants

	<i>Page</i>
Accounting Research Bulletins . . . . .	20,011
Accounting Principles Board Opinions . . . . .	20,021
Statements on Auditing Standards . . . . .	20,051
Statements on Standards for Accountants' Services on Prospective Financial Information . . . . .	20,111
Audit and Accounting Guides . . . . .	20,121
Auditing Interpretations . . . . .	20,141
Statements on Standards for Accounting and Review Services . . . . .	20,151
Accounting and Review Services Interpretations . . . . .	20,171
Statements on Quality Control Standards . . . . .	20,181
Quality Control Policies and Procedures for CPA Firms . . . . .	20,185

Financial Accounting Standards Board

FASB Statements . . . . .	20,201
---------------------------	--------

Governmental Accounting Standards Board

GASB Statements . . . . .	20,261
GASB Codification . . . . .	20,261

[The next page is 20,011.]



**Accounting Research Bulletins**

No.	Chap.	Par.	Sec.
43	2	1	2400.05
	4	. . .	6500.290

---

[The next page is 20,021.]



**Accounting Principles Board Opinions**

No.	Par.	Sec.	
20	13	10,260.150	
21	. . .	5400.220	(V)B8h(6)
	. . .	9210.090	(III)B12
	. . .	9230.040	(III)B13

---

[The next page is 20,051.]



**Statements on Auditing Standards**

No.	Sec.	Par.	Sec.	
1	530	. . .	10,100.11	
		. . .	3115.06	
		16	10,210.080	
		17	10,210.080	
	560	10	9210.180	(III)K2
		10	9220.120	(III)J2
		10	9230.110	(III)I2
		11	9210.180	(III)K2
		11	9220.120	(III)J2
		11	9230.110	(III)I2
		12	9210.180	(III)K2
		12	9220.120	(III)J2
		12	9230.110	(III)I2
	561	. . .	2300.13	(15)
		. . .	2300.18	(20)
		. . .	2400.14	
		. . .	2400.16	
3		. . .	9210.070	(II)A9
5		4	3120.01	
		9	3120.01	
7		. . .	2100.08	
		4	3130.09	
		4	9210.070	(II)A2
		5	9210.070	(II)A2
		6	9210.070	(II)A2
		7	9210.070	(II)A2
9		. . .	9210.070	(II)A7
		. . .	9230.010	(I)A3
11		. . .	3120.04	
		. . .	5400.240	(VI)B1d
		. . .	9220.150	(III)M3
		. . .	9230.140	(III)L3
		9	9210.210	(III)N3
		10	9210.210	(III)N3
		11	9210.210	(III)N3
		12	9210.210	(III)N3
12		. . .	5400.440	(XVI)B6
		. . .	7300.01	
		. . .	9220.010	(I)A9
		. . .	9230.010	(I)A11
		5	6500.650	
		6	6500.650	
		7	6500.650	
		10	7300.03	



**Statements on Auditing Standards—continued**

No.	Sec.	Par.	Sec.	
14		. . .	2600.05	
		8	10,260.010	
		8	10,260.020	
		8	10,260.030	
		14	10,260.040	
		14	10,260.050	
		14	10,260.060	
		14	10,260.070	
		19	10,260.100	
		19	10,260.110	
		19	10,260.120	
19		. . .	5400.030	(I)A3
		. . .	5400.460	(XVII)B5
		. . .	6500.650	
		. . .	7400.01	
		. . .	9210.070	(II)A17
		. . .	9220.010	(I)A19
		. . .	9230.010	(I)A10
		5	7400.01	
		12	5100.35	
20		. . .	10,250.040	
		. . .	10,250.041	
		. . .	10,250.060	
		. . .	10,250.070	
		9	10,250.041	
22		. . .	3100.03	
		. . .	5300.09	
		. . .	9100.06	
		. . .	9210.040	(I)D14
		. . .	9210.070	(II)A4
		. . .	9220.010	(I)A1
		. . .	9220.010	(I)A5
		. . .	9220.190	(IV)D13
		. . .	9230.010	(I)A1a
		. . .	9230.010	(I)A6
		. . .	9230.180	(IV)D13
26		5	10,270.01	
		7	10,270.03	
		7	10,270.04	
		8	3115.07	
		8	3165.03	
		9	3115.07	
		9	3165.03	
		10	3115.07	
		10	3165.03	
		10	10,280.01	
		16	10,270.02	

**Statements on Auditing Standards—continued**

No.	Sec.	Par.	Sec.	
26		17	10,210.170	
		17	10,210.180	
		17	10,210.190	
29		. . .	9220.150	(III)M2
		. . .	9230.140	(III)L2
		13	10,245.060	
		13	10,245.070	
		14	10,245.080	
		18	10,245.100	
30		. . .	9210.070	(II)A6
		. . .	10,250.060	
		. . .	10,250.070	
		37	10,250.030	
		37	10,250.040	
		37	10,250.041	
		38	10,250.030	
		38	10,250.040	
		38	10,250.041	
		39	10,250.010	
		39	10,250.020	
		39	10,250.030	
		39	10,250.040	
		39	10,250.041	
		39	10,250.050	
		40	10,250.020	
		40	10,250.030	
		40	10,250.040	
		40	10,250.041	
		41	10,250.030	
		41	10,250.040	
		41	10,250.041	
		42	10,250.030	
		42	10,250.040	
		42	10,250.041	
		43	10,250.020	
		43	10,250.030	
		43	10,250.040	
		43	10,250.041	
		44	10,250.030	
		44	10,250.040	
		44	10,250.041	
		45	10,250.030	
		45	10,250.040	
		45	10,250.041	
		46	10,250.030	
		46	10,250.040	
		46	10,250.041	

**Statements on Auditing Standards—continued**

No.	Sec.	Par.	Sec.	
30		49	10,250.030	
		49	10,250.040	
		50	10,250.040	
		51	10,250.040	
		59	10,250.050	
31		. . .	4700.01	
		. . .	4700.02	
		. . .	5100.05	
		. . .	5100.26	
		. . .	5100.34	
		. . .	5100.36	
		5	5100.27	
		9	9220.010	(I)A5b
		9	9230.010	(I)A6b
		10	9220.010	(I)A5b
		10	9230.010	(I)A6b
		11	5100.39	
		11	9220.010	(I)A5b
		11	9230.010	(I)A6b
		12	5100.08	
		12	9220.010	(I)A5b
		12	9230.010	(I)A6b
		13	9220.010	(I)A5b
		13	9230.010	(I)A6b
		22	5100.32	
35		. . .	2600.05	
		6	10,260.080	
		6	10,260.090	
36		. . .	10,300.01	
		. . .	10,300.02	
		. . .	10,300.03	
		. . .	10,300.04	
		. . .	10,300.05	
		17	10,100.11	
		18	10,300.01	
		18	10,300.02	
		19	10,300.03	
		21	10,300.04	
		22	10,300.05	
		24	10,300.06	
		25	10,300.06	
		26	10,300.06	
		27	10,300.06	
		28	10,300.06	
		29	10,300.06	
		30	10,300.06	

**Statements on Auditing Standards—continued**

No.	Sec.	Par.	Sec.	
39		. . .	5300.02	
		. . .	5300.03	
		. . .	5300.04	
		. . .	5300.05	
		. . .	5300.06	
		. . .	5300.07	
		. . .	5300.09	
		. . .	5300.26	
		. . .	5300.28	
		. . .	5300.34	
		. . .	5300.35	
		. . .	5300.38	
		. . .	9210.070	(II)A8
		. . .	9210.070	(II)A9
	1		5300.12	
	15		9220.010	(I)A7
	15		9230.010	(I)A8
	16		9220.010	(I)A7
	16		9230.010	(I)A8
	17		9220.010	(I)A7
	17		9230.010	(I)A8
	18		5300.08	
	18		9220.010	(I)A7
	18		9230.010	(I)A8
	19		9220.010	(I)A7
	19		9230.010	(I)A8
	20		9220.010	(I)A7
	20		9230.010	(I)A8
	21		5300.08	
	21		9220.010	(I)A7
	21		9230.010	(I)A8
	22		5300.08	
	22		9220.010	(I)A7
	22		9230.010	(I)A8
	23		5300.33	
	23		9220.010	(I)A7
	23		9230.010	(I)A8
	24		5300.08	
	24		9220.010	(I)A7
	24		9230.010	(I)A8
	25		5300.08	
	25		9220.010	(I)A7
	25		9230.010	(I)A8
	26		5300.08	
	26		9220.010	(I)A7
	26		9230.010	(I)A8
	27		9220.010	(I)A7
	27		9230.010	(I)A8

**Statements on Auditing Standards—continued**

No.	Sec.	Par.	Sec.	
39		28	9220.010	(I)A7
		28	9230.010	(I)A8
		29	9220.010	(I)A7
		29	9230.010	(I)A8
		30	5300.08	
		30	9220.010	(I)A7
		30	9230.010	(I)A8
		31	9220.010	(I)A6
		32	9220.010	(I)A6
		33	9220.010	(I)A6
		34	9220.010	(I)A6
		35	9220.010	(I)A6
		36	9220.010	(I)A6
		37	9220.010	(I)A6
		38	9220.010	(I)A6
		39	9220.010	(I)A6
		40	9220.010	(I)A6
		41	9220.010	(I)A6
		42	9220.010	(I)A6
41		. . .	5300.09	
		. . .	6100.01	
		. . .	9100.06	
		3	5400.240	(VI)B1f
		5	9230.020	(II)A7e
42		1a	10,550.01	
		6	10,550.01	
		7	10,550.02	
		8	10,550.03	
44		. . .	9100.070	(II)A3d
		. . .	9100.070	(II)A3e
		. . .	9220.010	(I)A3d
		. . .	9220.010	(I)A3e
		. . .	9230.010	(I)A5d
		35	10,250.080	
		41	10,250.081	
45		46	10,250.082	
		. . .	3120.05	
		. . .	5200.09	
		. . .	5200.10	
		. . .	5200.400	(XIV)B3
		. . .	9210.070	(II)A4b
		. . .	9210.210	(III)N4
		. . .	9220.010	(I)A5c
46		. . .	9220.150	(III)M4
		. . .	9230.140	(III)L4
		. . .	11,600.20	(III)A

**Statements on Auditing Standards—continued**

No.	Sec.	Par.	Sec.	
47		. . .	3140.02	
		. . .	3140.04	
		. . .	3140.14	
		. . .	9100.06	
		. . .	9210.210	(III)N5
		. . .	9220.010	(I)A1c
		. . .	9220.010	(I)A13
		. . .	9220.190	(IV)D13
		. . .	9230.010	(I)A1c
		. . .	9230.010	(I)A13
		. . .	9230.180	(IV)D13
		3	3140.17	
48		. . .	6500.690	
		. . .	9220.010	(I)A3d
		. . .	9220.190	(IV)D10
		. . .	9230.010	(I)A5d
		. . .	9230.180	(IV)D10
50		9	10,260.150	
52		. . .	9210.210	(III)N2
		2	10,245.010	
		2	10,245.015	
		2	10,245.020	
		2	10,245.025	
		2	10,245.030	
		2	10,245.035	
		2	10,245.040	
		2	10,245.045	
		2	10,245.090	
		2	10,245.095	
		3	10,245.050	
		3	10,245.090	
		3	10,245.095	
53		. . .	3150.05	
		. . .	5100.34	
		. . .	7400.01	
		. . .	9100.06	
		. . .	9210.070	(II)A10
		. . .	9210.070	(II)A11
		. . .	9220.010	(I)A1e
		. . .	9220.010	(I)A14
		. . .	9230.010	(I)A1e
		8	5100.33	
		12	3125.16	
		16	3125.16	
		17	3125.16	

**Statements on Auditing Standards—continued**

No.	Sec.	Par.	Sec.	
54		...	9100.06	
		...	9210.070	(II)A1f
55		...	3125.05	
		...	4100.01	
		...	4100.03	
		...	4700.03	
		...	5100.10	
		...	5400.060	(II)C9
		...	5400.090	(II)F9
		...	5400.090	(II)F9c
		...	5400.120	(II)I5
		...	5400.120	(II)I5c
		...	5400.150	(II)L7c
		...	9100.06	
		...	9210.070	(II)A3
		...	9210.070	(II)A4a
		...	9220.010	(I)A3
		...	9220.010	(I)A5a
		...	9230.010	(I)A5
		...	9230.010	(I)A6a
		...	9230.010	(I)A7
		...	9230.020	(II)A5a
		...	9230.020	(II)A6
		8	4100.02	
56		...	3120.05	
		...	5100.17	
		...	5400.220	(V)B3
		...	5400.220	(V)B11b(5)
		...	5400.245	(VI)G4
		...	5400.246	(VI)H1b
		...	5400.260	(VII)B15
		...	5400.320	(X)B7
		...	5400.400	(XIV)B1
		...	5400.420	(XV)B1
		...	5400.420	(XV)B1b
		...	5400.420	(XV)B1c
		...	5400.420	(XV)B1d
		...	6500.690	
		...	6500.050	
		...	9100.06	
		...	9100.20m	
		...	9220.010	(I)A8
		...	9230.010	(I)A9
57		...	5400.220	(V)B11b
		...	5400.320	(X)B8b
		...	9100.06	

**Statements on Auditing Standards—continued**

No.	Sec.	Par.	Sec.
58		8	10,210.010
		8	10,210.020
		8a	10,100.01
		9	10,100.06
		13	10,210.050
		26	10,210.150
		32	10,210.100
		35	10,210.090
		42	3130.08
		44	10,240.010
		44	10,240.080
		48	10,210.030
		53	10,240.020
		53	10,240.080
		53	10,245.080
		54	10,240.030
		56	10,240.040
		58	10,240.050
		61	10,240.060
		64	10,240.070
		69	10,220.01
		72	10,230.01
		72	10,230.02
		72	10,230.03
		74	10,100.11
		78	10,210.160
		82	10,100.11
		83	10,210.040
		83	10,210.060
		83	10,210.070
59		. . .	9100.06
		. . .	9100.201
		10	2500.29
		11	2500.29
		13	10,210.110
60		. . .	3130.11
		. . .	3165.07
		. . .	4100.03
		. . .	4200.16
		. . .	4200.18
		. . .	5400.030 (I)A2
		. . .	5400.060 (II)C9c
		. . .	9100.06
		. . .	9100.18
		. . .	9210.070 (II)A5
		. . .	9210.070 (II)A6
		. . .	9220.010 (I)A15
		. . .	9220.020 (II)A8b
		. . .	9230.010 (I)A16b

[The next page is 20,111.]





**Statement on Standards for Accountants' Services on Prospective Financial Information**

Sec.	Par.	Sec.
2100	58	10,400.22
2100	58	10,400.23

---

[The next page is 20,121.]



**Audit and Accounting Guides**

<b>Name of Guide</b>	<b>Sec.</b>
<i>Audit Sampling</i>	5300.32 5300.35 5300.39
<i>Audits of State and Local Governmental Units</i>	10,700.14 10,700.15 10,700.16 10,700.17 10,700.18 10,700.19 10,700.20
<i>Computer-Assisted Audit Techniques</i>	3120.05
<i>Personal Financial Statement Guide</i>	10,600.07 10,600.08 10,600.09 10,600.10 10,600.11 10,600.12 10,600.13 10,600.14 10,600.15 10,600.16 10,600.17

---

[The next page is 20,141.]



**Auditing Interpretations of Statements on Auditing Standards**

<b>Auditing Interpretation AU Sec.</b>	<b>AAM Sec.</b>
9311	9220.190 (IV)D13
9642.01—.03	10,250.060
9642.01—.03	10,250.070
9621.25	10,260.130
9621.25	10,260.131
9621.25	10,260.132
9621.31	10,260.140
9621.31	10,260.141

---

[The next page is 20,151.]



**Statements on Standards for Accounting and Review Services**

No.	Par.	Sec.	
1	. . .	2100.02	
	. . .	2100.03	
	. . .	2100.05	
	. . .	2100.06	
	. . .	2100.07	
	. . .	2100.09	
	. . .	2100.10	
	. . .	2100.11	
	. . .	2100.13	
	. . .	2200.05	
	. . .	2200.17	
	. . .	2300.01	
	. . .	2400.04	
	. . .	2500.09	
	. . .	2600.04	
	. . .	2600.05	
	. . .	7400.02	
	4	2100.04	
	6	2500.02	
	8	2200.04	
	8	2300.14	(1)
	8	2300.19	(1)
	8	3130.01	
	9	10,400.11	
	10	2300.14	(2)
	11	2300.14	(3)
	12	2300.14	(3)
	12	2300.19	(11)
	12	2500.26	
	12	10,400.12	
	13	2300.14	(4)
	14	2300.14	(14)
	14	2500.06	
	15	2300.14	(13)
	15	10,100.11	
	16	2300.14	(12)
	16	2400.03	
	17	10,400.01	
	17	10,400.04	
	17	10,400.12	
	17	10,400.13	
	17	10,400.14	
	17	10,400.15	
	17	10,400.16	
	17	10,400.22	
	17	10,400.23	
	19	2300.14	(5)



**Statements on Standards for Accounting and Review Services—continued**

No.	Par.	Sec.	
1	19	2300.14	(6)
	19	2500.17	
	20	2300.14	(6)
	20	2500.17	
	21	2300.14	(6)
	21	2500.17	
	21	10,400.02	
	21	10,400.03	
	22	2300.14	(9)
	22	2300.14	(10)
	22	10,280.01	
	22	10,400.04	
	24	2300.19	(4)
	24	2300.19	(6)
	26	2300.19	(5)
	27	2300.06	
	27	2300.10	
	27	2300.19	(6)
	27	2300.19	(7)
	27c	2300.08	
	29	2300.19	(8)
	30	2300.05	
	30	2300.19	(9)
	31	2300.12	
	31	2300.19	(14)
	31	7400.02	
	32	2300.19	(19)
	32	2500.11	
	33	2300.19	(18)
	33	10,100.11	
	34	2300.03	
	34	2300.19	(17)
	35	10,500.01	
	35	10,500.09	
	35	10,500.10	
	35	10,500.11	
	35	10,500.12	
	36	2200.15	
	36	2300.19	(10)
	36	2300.19	(11)
	36	2500.24	
	37	2500.15	
	38	2300.19	(2)
	38	2500.16	
	38	10,280.01	
	39	2100.07	
	39	2300.14	(7)
	39	2300.14	(8)
	39	2300.19	(12)

**Statements on Standards for Accounting and Review Services—continued**

No.	Par. <sup>o</sup>	Sec.	
7	39	2300.19	(13)
	40	2100.07	
	40	2300.14	(8)
	40	2300.19	(13)
	40	2500.22	
	40	2500.30	
	40	10,400.05	
	40	10,400.06	
	40	10,400.21	
	40	10,500.02	
	40	10,500.03	
	40	10,500.04	
	40	10,500.15	
	41	2100.07	
	41	2200.08	
	41	2500.23	
	42	2200.08	
	42	2300.14	(15)
	42	2300.19	(20)
	42	2400.14	
	42	2400.16	
	43	2200.08	
	43	2300.14	(11)
	43	2300.19	(15)
	43	2300.19	(16)
	43	2400.10	
	43	10,400.18	
	43	10,500.13	
	43	10,500.14	
	44	2200.08	
	45	2200.08	
	45	2200.09	
	46	2200.08	
	47	2200.08	
	47	2200.11	
	48	2200.08	
	48	2200.12	
	49	2200.08	
	App. A	2300.07	
2	. . .	2100.02	
	. . .	2100.05	
	. . .	2100.06	
	. . .	2100.08	
	. . .	2100.13	
	. . .	2400.06	
	9	10,500.07	
	10	10,500.08	
	15	10,400.13	
	15	10,500.09	

**Statements on Standards for Accounting and Review Services—continued**

No.	Par.	Sec.
2	18	10,400.15
	18	10,500.10
	19	10,400.14
	19	10,500.11
	28	10,400.16
	28	10,500.12
	30	10,400.17
3	. . .	2100.02
	. . .	2100.06
	. . .	2100.07
	. . .	2100.13
	2	2100.06
	2	2600.01
	3	10,400.19
	4	10,400.20
	5	2600.04
4	. . .	2100.02
	. . .	2100.08
	. . .	2100.13
	. . .	2200.18
	3	2200.18
	4	2200.19
5	. . .	2100.02
	. . .	2100.09
	. . .	2100.13
	2	10,400.01
	2	10,400.02
	2	10,400.03
	2	10,400.04
	2	10,400.05
	2	10,400.06
	2	10,400.11
	2	10,400.12
	2	10,400.13
	2	10,400.14
	2	10,400.15
	2	10,400.16
	2	10,400.17
	2	10,400.19
6	. . .	2100.02
	. . .	2100.10
	. . .	2100.11
	. . .	2100.12
	. . .	2100.13

[The next page is 20,171.]

**Accounting and Review Services Interpretations**

SSARS No.	Interp. No.	Sec.
1	1	2200.16
	4	2300.13 (15)
	4	2300.18 (20)
	4	2400.15
	4	2400.16
	11	2500.28
	11	10,400.21
	11	10,500.15
	14	2500.25
	14	2500.26
	12	10,400.07
	12	10,400.08
	12	10,400.09
	12	10,400.10
	12	10,500.05
	12	10,500.06

---

[The next page is 20,181.]



**Statements on Quality Control Standards**

No.	Par.	Sec.
1	. . .	9100.07
	. . .	11,100.01
	. . .	11,100.02
	7h	3125.17

---

[The next page is 20,185.]



**Quality Control Policies and Procedures for CPA Firms**

Sec.	Par.	Sec.
90	.09	3115.02
	.10	3115.02
	.11	3110.02
	.12	3110.02

---

[The next page is 20,201.]





# FINANCIAL ACCOUNTING STANDARDS BOARD

## FASB Statement of Financial Accounting Standards

No.	Par.	Sec.	
5	. . .	2500.28	
	. . .	5400.440	(XVI)B3b
	. . .	5400.440	(XVI)B5
	. . .	7300.01	
	. . .	7300.02	
	. . .	7400.01	
	. . .	9210.200	(III)M5
	. . .	9220.140	(III)L10
	. . .	9230.110	(III)I3
	. . .	9230.130	(III)K10
	103	5400.270	(VIII)A1f
12	11	6500.250	
13	6	9210.150	(III)H3
	6	9210.210	(III)N1
	7	9210.150	(III)H3
	7	9210.210	(III)N1
	8	9210.150	(III)H3
	8	9210.210	(III)N1
	9	9210.150	(III)H3
	9	9210.210	(III)N1
	10	9210.150	(III)H3
	10	9210.210	(III)N1
	11	9210.150	(III)H3
	11	9210.210	(III)N1
	12	9210.150	(III)H3
	12	9210.210	(III)N1
	13	9210.150	(III)H3
	13	9210.210	(III)N1
	14	9210.150	(III)H3
	14	9210.210	(III)N1
	17	9210.210	(III)N1
	18	9210.210	(III)N1
	20	9210.210	(III)N1
	21	9210.210	(III)N1
	22	9210.210	(III)N1
	24	9210.210	(III)N1
	25	9210.210	(III)N1
	26	9210.210	(III)N1
	27	9210.210	(III)N1
16	. . .	5400.381	(XIII)C3
	11	10,260.150	
22	12	9210.210	(III)N1
	13	9210.210	(III)N1
	14	9210.210	(III)N1

**FASB Statement of Financial Accounting Standards—continued**

No.	Par.	Sec.	
22	15	9210.210	(III)N1
23	7	9210.210	(III)N1
	8	9210.210	(III)N1
	9	9210.210	(III)N1
27	6	9210.210	(III)N1
	7	9210.210	(III)N1
	8	9210.210	(III)N1
28	2	9210.210	(III)N1
	3	9210.210	(III)N1
29	10	9210.210	(III)N1
	11	9210.210	(III)N1
	12	9210.210	(III)N1
36	. . .	7200.15A	
	. . .	7200.15B	
43	. . .	9210.140	(III)G5
47	. . .	2500.28	
57	24	7400.01	
87	. . .	7200.15A	
	. . .	7200.15B	
95	. . .	6500.064	
	3	2500.20	
98	12	9210.210	(III)N1

---

[The next page is 20,261.]

**GOVERNMENTAL ACCOUNTING STANDARDS BOARD****GASB Statements**

No.	Par.	Sec.	
2	. . .	9230.090	(III)G6

**GASB Codification**

Sec.	Par.	Sec.	
1600	. . .	9230.050	(III)G5
2100	. . .	9230.010	(I)A1b
C50	. . .	9230.110	(III)I3
L20	. . .	9230.140	(III)L1
P70	. . .	9230.040	(III)B8

---



**TECHNICAL HOTLINE**

**The AICPA Technical Information Service answers  
inquiries about specific audit or accounting problems.**

**Call Toll Free**

**(800) 223-4158 (Except New York)**

**(800) 522-5430 (New York Only)**

**This service is free to AICPA members.**